FEBRUARY 15, 2010 | BUSINESSWEEK.COM

GEITHNER'S TORMENTOR | TOYOTA FESSES UP

Bloomberg BusinessWeek



AT&T's iProblem

The iPhone has been a profit bonanza. But an overloaded network has AT&T at war with its customers

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Building a Smarter Planet: 1 in a Series

Welcome to the decade of smart.

A year ago, we began a global conversation about how our planet is becoming smarter.

We talked about intelligence being infused into the systems and processes that make the world work—into things no one would recognize as computers: cars, appliances, roadways, power grids, clothes, even natural systems such as agriculture and waterways.

We said that trillions of digital devices, connected through the Internet, were producing a vast ocean of data. And all of that information—from the flow of markets to the pulse of societies—could be turned into knowledge because we had the computational power and advanced analytics to make sense of it all.

A year into this new era, the signs of a smarter planet are all around us. Smarter systems are being implemented and are creating value in every major industry and across every region of both the developed and developing worlds.

This idea isn't a metaphor, or a vision, or a proposal—it's a rapidly emerging reality.

In a study of 439 cities, those with transportation congestion systems showed an average reduction in travel delays of more than 700,000 hours annually.

A yearlong study by the U.S. Department of Energy's Pacific Northwest National Laboratory found that consumers within smart meter systems saved 10% on their power bills and cut their power usage by 15% during peak hours.

Eight hospitals and 470 primary care clinics were able to improve clinical results and operational efficiency by up to 10% through information access at the point of care.

Leading retailers have reduced supply chain costs by up to 30% and increased sales by up to 10%—through analyzing buying behaviors, aligning merchandising with demand and building end-to-end visibility from manufacture to sale.

Everywhere, forward-thinking leaders are achieving near-term ROI. But they are also discovering something deeper. They are finding the hidden treasures buried in their *data*.

Data is being captured today as never before. It's revealing everything from large and systemic patterns—of global markets, workflows, national infrastructures and natural systems—to the location, temperature, security and condition of every item in a global supply chain.

Then there's the growing torrent of information from billions of individuals using social media. They are customers, citizens, students and patients. They are telling us what they think, what they like and want, and what they're witnessing. In real time.

That's a lot of data, but data by itself isn't useful. In fact, it can be overwhelming—unless you can extract value from it. And now we can. With the right tools, we are beginning to see patterns, correlations and outliers.

With sophisticated mathematical models, we can take the measure of the world's information and actually begin to predict and react to changes in our systems. New York has smart crime fighting. Paris has smart healthcare. Galway has smart water. A smart grid in Copenhagen keeps energy flowing.

We've learned a lot over the past year about what it takes to build a smarter planet—and about the issues it raises. Issues like protecting personal information and securing critical infrastructures. We've learned that we will need global standards across all dimensions of these complex systems. New skills and fields of expertise. New ways of working and thinking. A smarter planet also requires a profound shift in management and governance.

Business leaders, policymakers and government officials around the world understand these challenges, and are stepping up to them. Above all, they realize that we cannot wait, cannot let this moment pass. The time to act is now. And the way to act is together. The decade of smart is under way.

Let's build a smarter planet. Join us and see what others are doing at **ibm.com/smarterplanet**

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Bloomberg BusinessWeek In Depth



Groups of iPhone users have formed to push AT&T to spend more on improving its network

(COVER AND ABOVE) ILLUSTRATION BY MATT MAHURIN; COVER ILLUSTRATION BASED ON: ROTARY DIAL: PHOTODISC/GETTY IMAGES

34 | AT&T's iProblem

Securing exclusive rights to the iPhone seemed like a masterstroke. But the iPhone explosion has overwhelmed AT&T's mobile network and sparked a consumer rebellion. What can Ma Bell do?

42 | The Man with the Meanest Bank Shot

Economist Larry Kotlikoff says the Obama Administration's financial policy is "putting a band-aid on cancer." He wants to squeeze the risk out of banking, and powerful players are listening

46 | Take Your Meds, Exercise—and Spend Billions

The U.S. is about to commit big money to so-called disease management as one solution to rising health-care costs. But there's scant evidence it lowers costs

52 | Getting Over the JetBlues

Ousted after his airline's disastrous performance during a 2007 ice storm, JetBlue founder David Neeleman went seeking redemption—and found it in a low-cost Brazilian airline

BusinessWeek The Global Report



Issa isn't your starched-collar Republican

The Week in Business

06 | **Executive Summary** Obama's budget; Greece's woes; China's ire

13 | **At the Table** Charlie Rose talks with the NBA's David Stern about guns, gambling, and goodness

16 | **Business Outlook** Peter Coy: U.S. debt is near a tipping point

17 | **Numbers** Going for Olympic gold will cost Canada and NBC

New Business

18 | **Geithner's Tormentor** GOP Rep. Darrell Issa taps into public anger over Wall Street bailouts

21 | **Oh, What a (Hideous) Feeling** Toyota's tough road back

23 | **Who Needs an IPO?** Hot tech startups opt out of going public

24 | **Swine Flu Lessons** Learning from the pandemic that wasn't

26 | **Risk Returns** Wall Street regains its appetite for exotic investments

27 | **Indian Inflation** Prices are at decade-highs

28 | **All That Glitters** Bright prospects for platinum and palladium

30 | **Silvio vs. Rupert** Berlusconi and Murdoch battle to rule Italian TV

31 | **Reading Keynes in Tehran** Opening a B-school in Iran



Lousy CD rates? Guess who wins

What's Next

56 | **Learning from Business** Charter school powerhouse KIPP takes a page from *Good to Great*

58 | **Novartis' Speed Demon** Meet the quick-thinking new CEO

59 | **Labor's Grand Tour** U.S. unions are taking the fight to European employers' home turf

60 | **Go Global, Think Local** Time Warner's push for growth overseas

61 | **Mobile Net? Nah** India's reluctant users dim hopes for 3G profits

62 | **Japanese Import** China's automakers are hiring Japan's car guys

63 | **Guess Who Wins Again** How low interest rates benefit banks

64 | **What's Good for Goldman...** Lowering risk for small biz loans

66 | **Patent Troll?** Acacia Research's foes say it is one. Inventors differ

Personal Business

68 | **Money Report** Stellar profits for Netflix; a closer look at earnings; rising stock dividends for 2010

69 | **Retiring Wisdom** Retirees look back at their best and worst moves to help you avoid pitfalls

72 | **Fixing Your Bond Mix** With higher interest rates on the horizon, it's time to diversify

77 | **401(k) Outlook** The company match makes a comeback



Clinton: How business can help in Haiti

Business Views

78 | **Television** Walter Kirn on the mythmaking of *Undercover Boss*

80 | **Tech & You** Rich Jaroslovsky on making the iPad an iMust-Have

82 | **Books** Paulson: *On the Brink*

84 | **Outside Shot** Bill Clinton on how business investment can help re-create Haiti

83 | **Company Index**

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THE WEEK IN BUSINESS



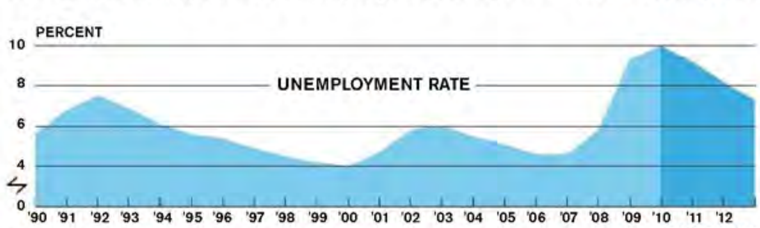
ECONOMICS & POLICY

AN OCEAN OF RED INK

President Obama on Feb. 1 presented a bad-news 2011 budget featuring a three-year freeze on nonsecurity discretionary spending and the expiration next year of Bush-era tax cuts for families earning more than $250,000. Even if Congress accedes, the White House projects red ink exceeding $10 trillion through 2020. Sluggish growth is exacerbating the problem; although the economy grew at a handsome 5.7% annual rate in the last quarter of 2009, economists surveyed by Bloomberg News expect it to slip back under 3% this year. In one attempt to fire up hiring, Obama called for using $30 billion in TARP money for loans to small businesses that increase employment.

PROTRACTED PAIN

Obama's budget predicts unemployment will remain elevated for years



Data: U.S. Labor Dept., White House

PSST! BANK INFO FOR SALE

Crime supposedly doesn't pay, but a banker who stole data on Swiss bank accounts held by 1,500 Germans will be rewarded with a $3.5 million payout. German authorities on Feb. 2 agreed to buy the illegally obtained information. The country is eager to prosecute the potential tax evaders, who moved funds to neighboring Switzerland. Experts reckon the info could bring a $279 million windfall in tax revenue.

THUMBS UP FOR GREECE

Many question whether debt-ridden Greece can tame its raging deficit, but the **European Union** on Feb. 3 backed the country's ambitious plan to chop spending and round up more tax revenue. The belt-tightening is supposed to cut the current 12.7% deficit

Presenting the budget book, which projects $10 trillion in deficits

15%

January increase in personal bankruptcy fillings from a year ago

Data: American Bankruptcy Institute

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EXECUTIVE SUMMARY



The U.S. will sell Blackhawk choppers to Taiwan, and Beijing is angry

to below 3% of GDP by 2012, though EU officials want regular updates after widespread auditing errors were found in Greece's national accounts last year.

THUNDER FROM CHINA

Enraged by U.S. plans to sell $6.4 billion worth of helicopters and antimissile systems to Taiwan, Beijing on Jan. 30 canceled military exchanges and threatened retaliation against **United Technologies, Boeing, Raytheon,** and **Lockheed Martin.** All four manufacture munitions intended for Taiwan, but UTC, which is supplying **Blackhawk** helicopters, and Boeing, which makes **Harpoon** missiles, have the most at stake. UTC sells elevators, air conditioners, and fire security systems in China, and builds the frames for its helicopters on the mainland, too.

STRATEGY

TOYOTA IN TROUBLE

Skeptical about its recall of 5.6 million cars to either replace floor mats or repair a faulty gas pedal system, members of Congress have demanded that Toyota back up its repeated claim that electronic systems are not to blame for unintended acceleration incidents. **Transportation Secretary Ray LaHood** on Feb. 2 said he was pondering civil penalties and advised owners of the recalled cars to stop driving them until Toyota replaces the accelerator pedal, but later backed off the statement. Separately, the U.S. and Japanese governments ordered investigations of the brakes on the carmaker's popular **Prius** hybrid after some owners complained about their lack of responsiveness.

| BW | PAGE 21 "Oh, What a (Hideous) Feeling"

THE LITTLE MOVIE THAT COULD

Director **Kathryn Bigelow's *The Hurt Locker*** may already be this year's big Oscar winner. Tied with mega-blockbuster ***Avatar*** at nine nominations, the gritty Iraq War film is expected to see the biggest box-office bounce in the weeks before the Mar. 7 awards ceremony. Encouraged by the nominations, **Summit Entertainment** will likely add to the mere 535 screens on which the movie is currently playing. *Avatar* is playing on 3,400 U.S. screens.

THE BATTLE FOR MGM

Ukrainian-born billionaire **Len Blavatnik,** a New York-based industrialist with TV holdings in Britain, is among the finalists in the auction to buy debt-ridden MGM. He joins Hollywood players **Time Warner** and **Lions Gate Entertainment** and cable baron **John Malone's Liberty Media** in the second round of



THE OPTIMISM METER

EXPANSION UNDER WAY?

The Meter clocked in at 45 on Feb. 2, up from 37 one week earlier as a survey of Americans showed that only 36% still believe the economy is getting worse. Economists now forecast that GDP will grow by 2.7% in 2010. Developed by ***Bloomberg BusinessWeek*** using data from pollster **YouGov,** the Meter is a proprietary measure of sentiment and expectations, economic statistics, and market forecasts. It evaluates shifts in outlook among individuals, professional investors, and economists in the areas of U.S. economic growth, jobs, equity markets, and real estate.

Calculated using consumer polling, economic forecasts, and financial markets data; 0=lowest and 100=highest Data: YouGov, *Bloomberg BusinessWeek*



Bigelow with a Critics Choice award for *The Hurt Locker*

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EXECUTIVE SUMMARY



A Kindle reader: Amazon backed down after a spat over pricing with Macmillan

bids, which could come in the next month. Another contender is hedge fund **Elliot Associates,** which bid for itself and **Relativity Media,** a film financing company headed by venture capitalist **Ryan Kavanaugh.** MGM's top assets are its 4,000-film library and its rights to distribute the **James Bond** films.

TECHNOLOGY

AN E-BOOK FRACAS

Amazon.com played rough for two days—then capitulated. After briefly suspending all sales of **Macmillan** books, Amazon on Jan. 31 said it would allow Macmillan, one of the largest publishers of e-books, to set its own prices for titles on the **Kindle** and keep 70% of sales. The New York publisher intends to offer new best sellers for $12.99 to $14.99, a big bump up from the $9.99 that Amazon usually charges. Anticipating pressure from **Apple's iPad,** which will connect to an Apple digital bookstore and reading application, other publishers are expected to push Amazon to match Macmillan's terms. "We don't like the Amazon model," said **Rupert Murdoch,** whose **News Corp.** owns **HarperCollins,** on Feb 2.

"Amazon's E-book Price Reversal: A Mixed Blessing" businessweek.com/magazine

BOSTON SCIENTIFIC PAYS UP

A nasty patent fight over heart stents, the tiny mesh tubes that prop open clogged arteries, came to an end on Feb. 1 when Boston Scientific agreed to pay $1.73 billion to **Johnson & Johnson's Cordis** unit. The spat, during which the two companies lobbed a dozen lawsuits at each other, dates back to 2003 and involves three separate patents. The rivals haven't quite buried the scalpel, however: J&J points out in a statement that it is pursuing patent litigation over Boston Scientific's **Promus** stents.

IDEAS BEHIND THE DECLINE OF BOSTON'S INVESTMENT FIRMS

Boston hosts an impressive array of mutual fund firms, and the dean of local stockpickers used to brag that he could do better than his brethren in New York. **Peter Lynch** of **Fidelity's Magellan Fund** wrote a book in 1989, *One Up On Wall Street,* that became a best seller. During Lynch's tenure, from 1977 to 1990, Magellan gained 29% a year, compared with the 15% return on the S&P 500. Yet a Feb. 2 Bloomberg News report shows that mutual fund stalwarts such as **Fidelity Investments, Putnam Investments,** and **MFS Investment Management** have seen their overall share shrink over the past decade as traditional stockpicking has lost favor among retail investors and returns trailed some rivals. The three held 12% of the $6.9 trillion in equity and bond funds in December, down from 21% a decade earlier. **Don Phillips,** managing director of **Morningstar,** the Chicago outfit that tracks the industry, believes the bear markets of 2000-02 and 2007-09 dimmed the appeal of Lynch's style. "The stockpickers didn't do a very good job of sidestepping the two bubbles we had," says Phillips.

Investors pulled $37 billion from actively managed stock funds last year, according to Morningstar. Much of that money found its way into bonds, index-tracking funds, or exchange-traded funds—categories where Boston's big firms have never been strong. The damage has been more than reputational, with the city's fund companies cutting employment and moving jobs out of state to lower costs.



Lynch, who ran Magellan Fund, still believes in old-fashioned stockpicking

Lynch, for one, is not prepared to admit defeat. "Finding money managers who can effectively pick stocks has long been a good way for investors to build wealth, and I think that will be true for the future," wrote Lynch in a Jan. 29 e-mail to Bloomberg.

Bloomberg News

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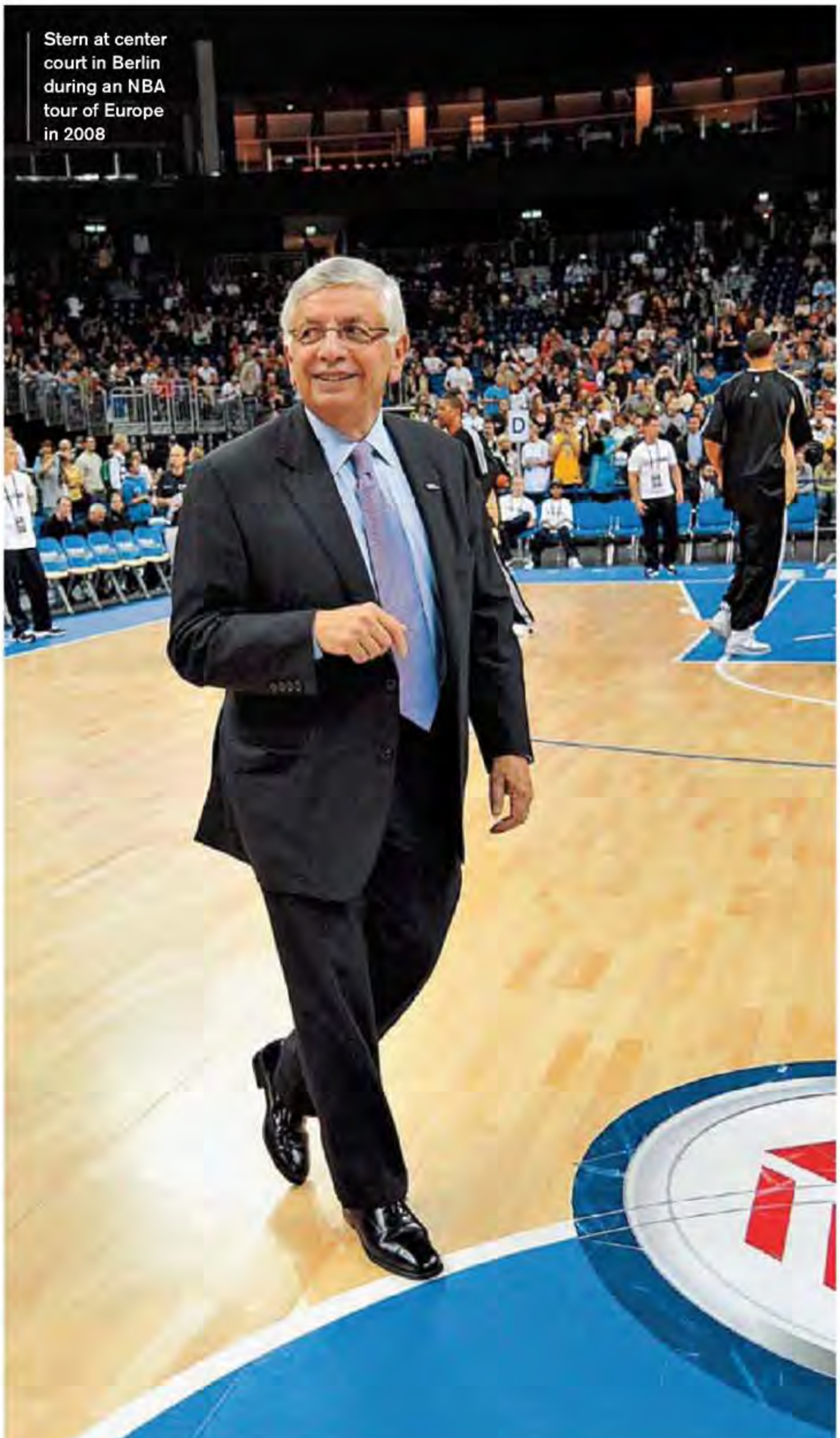
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AT THE TABLE CHARLIE ROSE





Stern at center court in Berlin during an NBA tour of Europe in 2008

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DAVID STERN OF THE NBA

Guns, goodness, and gambling

The NBA All-Star Game is on Valentine's Day this year, but David Stern is unlikely to be getting a dozen long stems from Washington Wizards fans. In one of his toughest rulings in 26 years as commissioner, Stern suspended Wizards Gilbert Arenas and Javaris Crittenton for the rest of the season for bringing handguns into the team locker room after an argument over a card game. I talked with Stern about the pressure on young players, the league's mentorship responsibilities, and the state of the basketball business.

CHARLIE ROSE

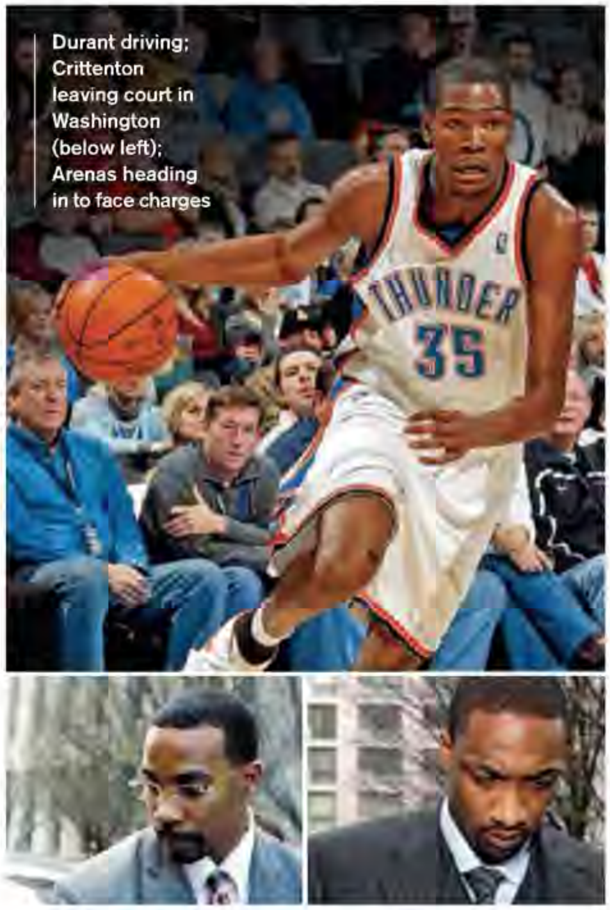
What's the shape of the NBA as you approach this All-Star Game?

DAVID STERN

The game itself is in terrific shape with the young stars who were in Beijing and will be in the world championships—players like LeBron James, Chris Bosh, Dwyane Wade, and Carmelo Anthony. And this year, Kevin Durant and a group of youngsters are improving dramatically in Oklahoma City.

Kevin Durant just got 41 points.

The Bobcats are winning, Memphis is winning. And if you're the commissioner, you like to see some of the W's spread around. The business of the game, considering the economy, is also in excellent condition. We're going to suffer only like a 2% loss in attendance this year in the worst economic downturn of our lifetime. Our sponsors are beginning to spend again. We've got


Durant driving; Crittenton leaving court in Washington (below left); Arenas heading in to face charges

new arenas going up—Orlando, here at the old Madison Square Garden, and of course the Nets will be breaking ground in Brooklyn. So life is good.

How many franchises don't make money? More than 10?
Oh, probably closer to almost 15. There are plenty of corporations that don't make money, but their stock is robust and their prices go up. Actually, we're heading into a collective bargaining negotiation, and ... we need a sustainable business model where every team has the opportunity to break even or make some money. We are trying to compress the difference between the highest team and the lowest team because what we're selling is competition.

Why do they pay commissioners such big salaries?
Commissioners have evolved into CEOs. In this case it's a \$4½ billion enterprise with a market cap of \$12 billion to \$15 billion. We're in consumer products, sponsorships, events. We're in the Web business. We run our own network. NBA TV is approaching 15 million homes. In our own way, we're one of the largest providers of reality programming, with 1,200, 1,300 episodes a year. There is a huge array of assets that get managed under this umbrella.

The Wizards. Guns in the locker room. Suspended players.
Let the record show those are all statements and not questions. Counselor, is there a question pending?

When you heard about this, what did you say? Drawing guns in the locker room of an NBA franchise?
Well, it wasn't exactly drawing guns. But the mere possession of guns in the locker room was horrible and dumb enough without embellishing it with even more threatening descriptions.

So they're out for the season?
Yes. Half the world will think it's too severe, half will be convinced that I should have barred them for life. But you do what you think is fair on all the facts. It cost Gilbert several million dollars. Javaris was in a rookie contract, but nevertheless it cost him huge sums average people can't identify with. And they were remorseful.

LOOK WHAT HAPPENED WHEN MAGIC ... ANNOUNCED HE WAS HIV-POSITIVE. IT CHANGED THE DEBATE ON AIDS

How much of all this has to do with fame and money and emotional immaturity?
Our guys are very reflective of their age group, between 19 and 34. When I say there are too many guns out there—which is my view, not anyone else's—our players are part of that issue. NFL players are part of that issue. And one of the things I've always been sensitive to is that it's easy to generalize and say, "Well, these players are thugs and punks. There they are, the tattoos, the corn rows" These players are not thugs and punks. The 430 players of the NBA do more on average for their communities than any similar group of people anyplace in the world.

But because of who they are, they get a lot of attention if they do anything.
They are attention-grabbers, and they recognize that. It's hard. They're human, too. But they have an enormous opportunity to change values. Look what happened when Magic Johnson announced he was HIV-positive. It changed the debate on AIDS in this country.

What's your responsibility, because they're young and famous and making tons of money?
The responsibility is to help guide them through these treacherous fields, and we do.

Do you really do that?
Yes, we do. If a college graduates most of its students but three get into trouble, is it "Oh my God, that's a bad college?" It's not. You have to look at the masses. We have somebody working with our players to complete their studies ... or do online education about life skills, things they need.

Have you opened the door a little to legalized gambling on basketball?
Not exactly. What I've done is explained my own journey, which is going from [speaking out against] the legalization of gambling in Atlantic City ... to now, where 46 states have gambling, and people are rushing straight into organized legal [sports] gambling.

So you think it's worth studying?
I think it's worth studying by my successor because it is not lost on me that you can walk into a soccer match in England and place a bet in the stadium. I can't imagine that happening in our case, but as our legally elected representatives begin looking for new sources of revenue, I fear/expect that sports betting is going to appear on their radar. |BW|

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BUSINESS OUTLOOK | PETER COY

U.S. DEBT: IT'S NOT DARK YET, BUT IT'S GETTING THERE

While there are still buyers for Treasury obligations, new research suggests the U.S. may cross a line in 2010 that kills investor confidence—and long-term growth

Is the U.S. approaching a tipping point with global investors? That was a natural question to ask on Feb. 1 after President Barack Obama released a federal budget that envisions big deficits out to 2020, adding to the government's already enormous pile of liabilities. Big debts aren't a new problem, of course. And so far, despite offering near-record-low interest rates, the U.S. government has had no problem finding buyers for its Treasury bills, notes, and bonds. But with total federal debt projected to equal the size of America's annual gross domestic product by fiscal 2011 or 2012 (chart), many economists worry that investors could suddenly lose confidence in the U.S., demanding higher interest rates to reward them for the risk they're taking.

94%

The projected ratio of federal debt to GDP. A ratio above 90% may slow growth.

Data: OMB; Kenneth Rogoff and Carmen Reinhart

As Greece is discovering to its chagrin, a loss of investors' confidence can quickly spin out of control. If the U.S. has to pay higher rates to finance its borrowing, its total interest payments will shoot up. At that point, the government will either have to cut spending and raise taxes or take out new loans to cover the interest on the old ones. The first solution is politically unpopular and the second is lethal to market confidence. If creditors conclude the U.S. doesn't have the political will to get its deficit spending under control, they may well panic, driving rates even higher, pushing up interest payments further, and so on in a vicious and dangerous cycle.

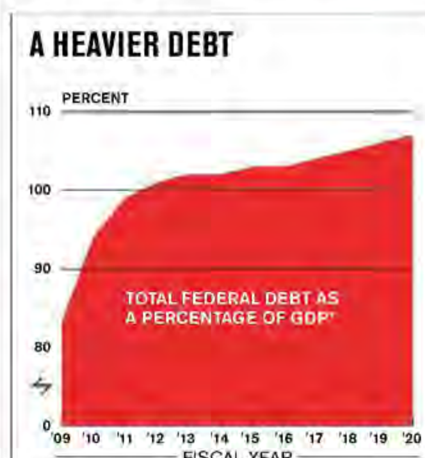
In a paper published last month called "Growth in a Time of Debt," economists Kenneth Rogoff of Harvard University and Carmen Reinhart of the University of Maryland say that historically, advanced economies have slowed noticeably when their debt-to-GDP ratio has exceeded 90%. (That's total debt, not just the publicly held portion.) According to the Obama Administration's Office of Management & Budget, the total debt-to-GDP ratio was 83% in fiscal 2009 and is on track to hit 94% this year, 99% in 2011, and 101% in 2012. Debt could go even higher if the President fails in his quest to allow the expiration of Bush-era tax cuts on families earning over $250,000 a year and to freeze nonsecurity discretionary spending for three years.

The U.S. experience with very high debt goes back to the years immediately following World War II, when the government tightened its belt to work off the costs of financing the war and the economy fell into recession. In an interview, Rogoff says investor confidence is more of a concern now than it was then. "Wartime expenditures come down easily. Plus, you have a huge labor force you can absorb, which boosts growth." This time around the U.S. has neither advantage: There's no easy way to cut spending, and the economy doesn't seem capable of absorbing the huge mass of unemployed. So, says Rogoff, "It's much harder to convince markets, as Obama will learn, that you really mean business."

Rogoff says the threshold for the U.S. may be higher than 90% this time, giving a few more years of breathing room. Also, he says, the reaction of investors may be less abrupt than it was for Greece. Still, he argues, "It happens more gently, but it has to happen."

Economists Nancy Marion of Dartmouth College and Joshua Aizenman of the University of California at Santa Cruz also see economic lessons in America's immediate postwar experience. But they draw a more positive conclusion. In a new research paper, "Using Inflation to Erode the U.S. Public Debt," they say that average growth in the decade after the war ended was actually pretty good. Inflation was higher, but that wasn't so bad, since inflation eroded the real value of the government's debt, lightening the burden on taxpayers. The same thing could happen this time. "Eroding the debt through inflation," they write, "is not far-fetched."

Far-fetched? Perhaps not. But it is risky. In an interview, Aizenman acknowledges that investors could quickly bail out if they sense that the U.S. is letting inflation rise on purpose. Globalization makes it easier to shift funds to other countries than it was in the 1940s. As the financial crisis demonstrated, things can go to hell in a hurry. | BW |



*Projections, except for 2009
Data: Office of Management & Budget

CHART BY DAVID FOSTER/BW

NUMBERS

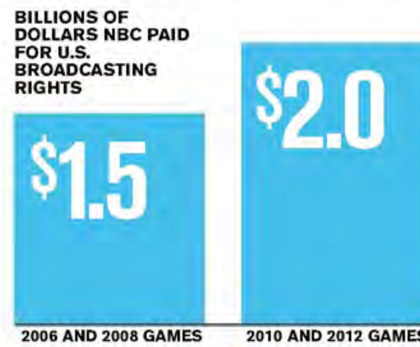


VANCOUVER OLYMPICS: GOING FOR THE GOLD AIN'T CHEAP

By Tara Kalwarski/Charts by David Foster

Canada will likely spend more on the Winter Games than it will get back in revenue, especially if construction costs are included. Likewise, NBC probably won't earn as much from ads as it paid for broadcasting rights.

TV Bust: NBC Universal parent General Electric expects to lose $250 million on the 2010 Games.



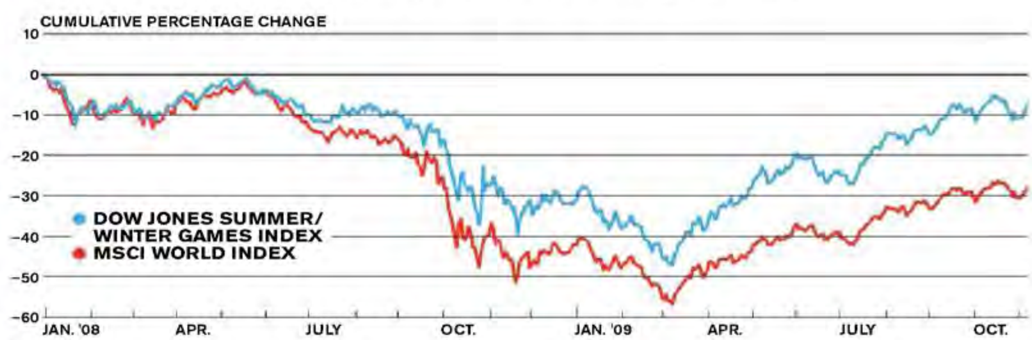
Data: International Olympic Committee

$1.8 billion

Estimated operating budget in Canadian dollars for the 2010 Games, not including the cost of building and renovating venues.

Data: Vancouver 2010 Organizing Committee

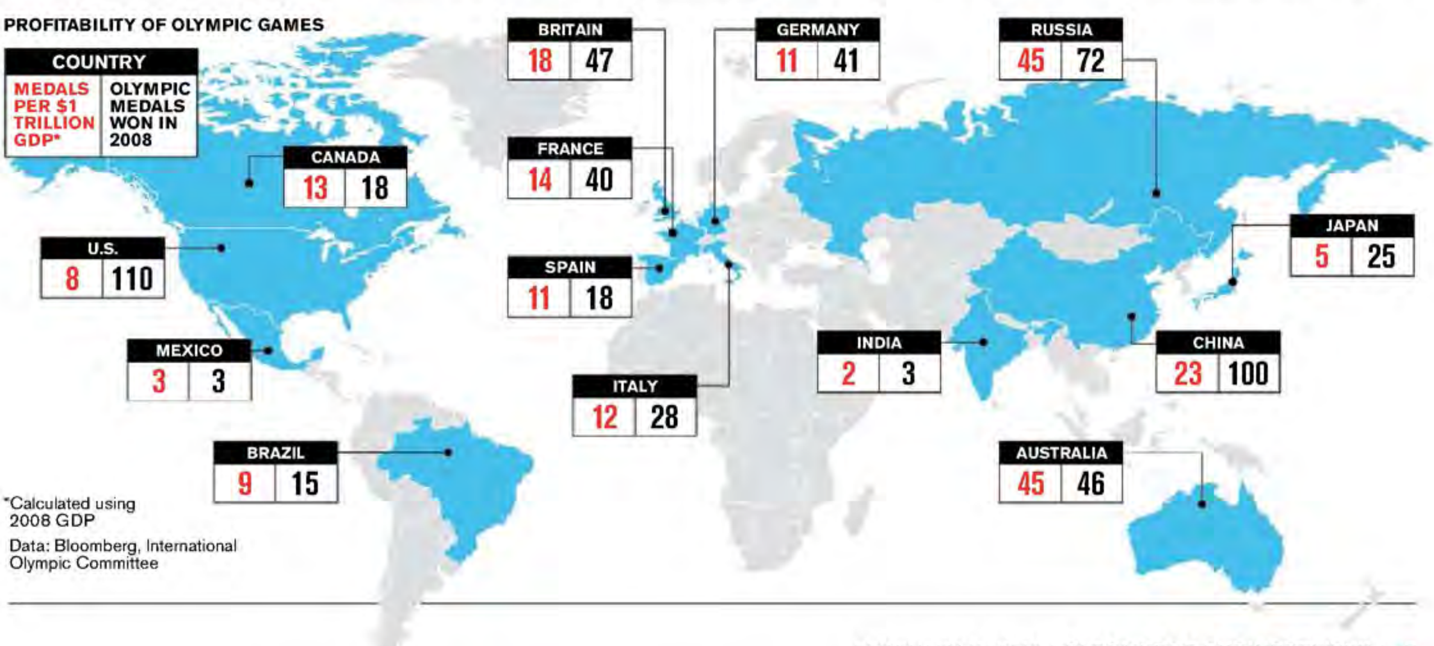
In on the Action: An index of 36 companies that are sponsoring the 2010 Games in Vancouver has outperformed the broad global market.



Data: Bloomberg

MEDALS FOR THE MONEY

Among the big countries at the 2008 Games, Australia and Russia took home the most medals per trillion dollars of GDP.



*Calculated using 2008 GDP

Data: Bloomberg, International Olympic Committee

21 Toyota's tough road back
23 Tech outfits spurn IPOs
24 Swine flu lessons
26 Wall Street's flight to risk
27 India: Price pains
28 More precious than gold
30 Italian TV: Silvio vs. Rupert
31 B-school for Tehran?

Geithner's Tormentor

Darrell Issa won't rest until Treasury and the Fed tell all about their roles in bailing out Wall Street firms

By Robert Schmidt

Since Newt Gingrich's 1994 Republican Revolution, House Republicans have been the self-appointed brawlers of the federal government—fighting for their beliefs, sure, but also sometimes for sport. After a 2008 pummeling, the GOP lost 21 House seats and also its enthusiasm for an old-fashioned scrap.

2010, though, is a more promising year for fans of political fisticuffs, thanks largely to Darrell E. Issa, the five-term California Republican congressman and bantam-weight challenger of President Barack Obama's economic policies. Issa (pronounced *eye*-suh) has exploited public anger over Wall Street and focused attention on the Administration's judgment and conduct during the bailout frenzy.

Raised in modest circumstances in the Cleveland area during the 1960s (Issa's father, the son of a Lebanese immigrant, was a General Motors truck salesman who moonlighted as an X-ray technician), Issa says he was "a kid who grew up looking out at greater wealth and greater power. I have a healthy questioning of government and power." Those on the receiving end of a blast from Issa—the wealthiest member of Congress, worth about $250 million from the sale of Directed Electronics, a car-alarm company he started—have tended to dismiss him as an opportunist and bomb-thrower. If so, he's an effective one. In his role as the senior Republican on the Oversight & Government Reform Committee, Issa has won party raves for his inquisition of Treasury Secretary Timothy F. Geithner over his role in the $182 billion bailout of insurer American International Group. "There is no one you'd less want to get into a fight with than Darrell Issa," says Sam Geduldig, a former House Republican leadership aide who is now a financial services lobbyist in Washington. "He is our Waxman."

"THERE IS NO ONE YOU'D LESS WANT TO GET INTO A FIGHT WITH THAN DARRELL. ... HE IS OUR [HENRY] WAXMAN"

That would be Representative Henry A. Waxman, the California Democrat and legendary pit-bull investigator who is an inspiration of sorts for Issa. When Waxman ran the oversight panel—the current chairman is Representative Edolphus Towns (D-N.Y.)—Issa says he took careful notes while Waxman hammered away at the Bush Administration over the Iraq War, Halliburton, and Hurricane Katrina.

Issa, 56, has at times out-maneuvered Towns, who was embarrassed last year when his own home loans from Countrywide Financial, the subprime lender, became public. Last year, Issa pressed the panel to vote to sub-

STEPHEN VOSS



Issa called Bernanke an "unindicted co-conspirator" in the AIG bailout



Issa says Geithner & Co. "were disingenuous with us"

MADELINE MARSHALL/UPI

poena documents on the Countrywide VIP loans to lawmakers from the lender's new owner, Bank of America. Towns, who received a mortgage via the same Countrywide unit that ran the program but denies he received special treatment, postponed a hearing claiming scheduling conflicts.

So Issa's staff waited by a side door of the committee room that day with a video camera and taped the Democrats walking away. Though it was unclear whether they had real appointments or were trying to head off political humiliation, Issa's staffers used the tape to produce a video set to the tune of *Hit the Road, Jack*. The tape soon made the rounds online. Towns relented a few days later and issued the subpoena.

Such tactics suggest that Issa is hardly a starched-collar Republican—and he has the rap sheet to prove it. As a young man, he was charged twice with auto theft (both times the charges were dropped) and convicted of misdemeanor gun possession (he paid a small fine and did three months' probation). After two stints in the Army, Issa's brushes with the law inspired him to launch Directed Electronics, which makes the Viper car alarm. (If you own one, that's Issa's voice saying, "Please step away from the car.")

That wealth came in handy in 2003 when Issa gained national prominence as the key money man behind the campaign to recall Democratic Governor Gray Davis. Though he has long tried to be heard on issues ranging from immigration to Middle East affairs, it's Issa's calls for greater transparency of the massive $787 billion economic stimulus package and ongoing bank bailouts that have finally made him a national force.

His investigations rarely turn up smoking guns, but that's not the point. Instead he ties up his targets for months with hostile questions and subpoenas. Strategic leaking is also part of the package. The panel's investigative reports and subpoenaed documents often hit the news shortly before a hearing. "You in the press are our greatest resource," says Issa.

Issa says he will continue his probes into AIG and Countrywide. The Administration's stimulus spending and the $700 billion banking rescue will also be an ongoing focus of the panel, he says. Another target: the Federal Reserve and its chairman, Ben Bernanke, the "unindicted co-conspirator" at the panel's recent hearing on the AIG bailout, he says.

The Fed chairman, Geithner, who was president of the New York Federal Reserve Bank at the time, and former Treasury Secretary Henry M. Paulson Jr. were slow to tell lawmakers about the extent of AIG aid even as they were beseeching Congress to pass the $700 billion Troubled Asset Relief Program in 2008, Issa says. "They were disingenuous with us, even if they didn't outright lie." Spokespersons for all three declined to comment.

Under questioning from Issa and others, Geithner confirmed that he recommended paying AIG's trading partners, including Goldman Sachs and several foreign banks, full price to unwind their derivatives contracts. Still, Geithner said he was already picked to lead the Treasury and thus recused from the November 2008 decision not to publicly reveal the payouts. The recusal, never formalized in writing, speaks to Geithner's character, Issa says. "That's a Geithner story: He's there for the ribbon-cutting and not for the cracked road."

Issa says there will be more revelations to come regarding AIG and Countrywide, even as critics argue it's time to move on from the blame game. "Tarring and feathering someone is not going to fix this," says Bill Brown, a visiting professor at the Duke University School of Law and former Morgan Stanley managing director. Issa seems to be having far too much fun brawling to heed such advice. |BW|

DARRELL E. ISSA'S REMARKABLE JOURNEY

November 1953: Born in Cleveland, the son of a GM salesman.

February 1980: Issa and brother William are arrested by San Jose (Calif.) police on a felony auto theft charge. They plead not guilty; the prosecutor asks for dismissal for lack of evidence. The brothers were previously indicted in 1972 for allegedly stealing a Maserati in Cleveland. That case was also dropped.

February 1982: Issa starts Directed Electronics, the maker of Viper car alarms. The company becomes the nation's largest maker of car security systems.

November 2000: Issa is elected to the House, representing San Diego County. Now in his fifth term, he is the wealthiest member of Congress with an estimated net worth of $250 million.

May 2003: Issa finances a recall of then-Governor Gray Davis, but his hopes to run for the office are dashed when Arnold Schwarzenegger enters the race.


CEO Toyoda waited weeks to apologize—and did so only when a reporter cornered him

TOMOHIRO OHSUMI/BLOOMBERG NEWS

Oh, What a (Hideous) Feeling

Why Toyota may take years to win back the confidence of car buyers, assuming the flurry of recalls is over

By David Welch

Like many Toyota owners these days, Bob Manke is suffering buyer's remorse. Even before Toyota recalled millions of cars to repair balky accelerator pedals, Manke, a retired finance director from St. Paul, Minn, was growing unhappy with his 2009 Camry. The dashboard makes a buzzing sound, he says, and the interior feels cheap. Manke plans to ditch the car this fall, possibly for a Buick Regal or a Volkswagen Jetta. It's not that he is afraid that the accelerator will get stuck and cause an accident. "I'm not a nervous wreck," Manke says. It's that he feels the overall quality of Toyota's cars has slipped. "Will I buy another one? No."

Winning back the Bob Mankes of the world will be tough. Toyota's most recent recall has affected eight of its most popular models. After years of being the benchmark for quality, Toyota has been losing its edge even as its rivals catch up. And while vehicle recalls are fairly common, those of this magnitude and seriousness tend to stick in consumers' minds. "Big recalls like this can kill a brand, and there's no way back in the short term," says Maryann Keller, an adviser with industry consultant Casesa Shapiro. "It takes years."

DO THE RECALL RIGHT

Making matters worse, Toyota's handling of the biggest crisis in its history has at times seemed inept and plodding. Crisis specialist Michael S. Sitrick says companies should dispatch an executive to publicly state: "We're working around the clock to find a fix." In 2000, when Ford Explorers equipped with Firestone tires began rolling over, John T. Lampe, then Firestone's U.S. chief, went on TV to assure customers that his company would take care of them and give them new, reliable tires. By contrast CEO Akio Toyoda waited weeks before issuing an apology, and he did so only after being cornered by a reporter in Davos. Then Toyota executives contradicted one another. Shinichi Sasaki, the company's top quality officer, told Japanese media that Toyota had to be prodded to launch a recall; U.S. spokespeople maintained that Toyota was moving voluntarily.

By late January, Toyota began issuing apologies and promises to do better; its engineers concocted a fix for the accelerator pedals and began rushing it to dealers around the world. But by then the company had lost control of the story. That became painfully apparent when U.S. Transportation Secretary Ray LaHood, testifying before the House of Representatives on Feb. 3, suggested that Toyota owners should stop driving recalled models until they had taken them into a dealership

for repair. LaHood reversed himself afterwards: "What I said in there was obviously a misstatement."

Toyota dealerships around the U.S. were soon fielding phone calls from panicky customers. "The comment scared a lot of people, and it caused a lot of grief at the dealership," says Joel Johnson, service manager at Toyota of Richardson in Richardson, Tex. "The phones were ringing off the wall. When a person of authority makes that kind of statement, people think it's gold."

Meanwhile, some safety experts are questioning whether Toyota's remedy will solve the pedal problem. LaHood said that his department is trying to determine whether the cause of the sticking accelerators is mechanical, as Toyota insists, or whether the electronic throttle system is the real culprit, as several class actions allege. He also said the U.S. government may seek civil damages over how Toyota handled the recall.

Toyota executives say that the company has not lost its ability to make safe, reliable cars. A few years ago, Toyota brass recognized that rapid expansion—the company doubled its sales between 2000 and 2008—was hurting quality. In 2006 the carmaker launched a campaign called Customer First to root out defects. But James Lentz, Toyota's U.S. chief, conceded at a press conference on Feb. 1 that "we need to be vigilant. We have to redouble our efforts to make sure this doesn't happen again."

Millions of Toyota cars currently on the road were engineered and manufactured before the company launched its quality crackdown. The risk is that more quality problems will emerge, forcing Toyota to announce another embarrassing recall. Already problems are cropping up with the Prius, Toyota's iconic hybrid. On Feb. 3 the Japanese government announced that it had ordered Toyota to test the brakes on its latest version of the Prius after getting complaints that they sometimes stop working momentarily at slow speeds and on slippery surfaces. In the U.S., according to the National Highway Traffic Safety Administration's Web site, owners of the 2010 Prius had filed 111 brake-related complaints by Feb. 3. By comparison, the Chevrolet Malibu got two complaints of any kind. NHTSA is now launching an investigation into problems with the Toyota .

$155 million

The estimated weekly damage to Toyota from lost sales since the recall

Data: UBS

All the bad news gives buyers another reason to look at other brands. TrueCar, a Web site where consumers can research car prices, says that from Jan. 1 to Jan. 25, the number of people showing interest in buying a Toyota fell 12%. TrueCar says Kia, Ford, and Honda appeared to be benefitting the most from Toyota's troubles. Jesse Toprak, TrueCar's vice-president for industry trends, thinks Toyota may have to cut its prices for a while. "It's not like 10 years ago when Toyota buyers would just let this go," he says. "Would you buy a Toyota Corolla that went through this recall for the same price as a Honda Civic?"

Toyota dealers were inundated with phone calls from panicked customers



REFOCUS ON QUALITY

One area that Toyota will have to focus on is how it manages its relationships with suppliers. Toyota says it plays a big role in engineering parts made by outside firms. But in recent years the company has been demanding that suppliers make parts more cheaply. An executive at a major U.S. supplier says Toyota has insisted that his firm make each generation of parts 10% cheaper. Analysts say the scrimping, while understandable in such a competitive industry, has been showing up in Toyota's cars. Eric Noble, president of The CarLab, a California consulting firm, says even before the recall, consumer focus groups were saying that cars like the Chevrolet Malibu had better interiors than Toyotas.

Toyota says it will more closely monitor quality. However, the company may need to overhaul its design, engineering, and manufacturing operations, as Ford did after the Explorer fiasco. Ultimately, Toyota will have to decide if being the biggest car company on the planet is worth sacrificing the attention to detail that made it such a formidable competitor. | BW |

MICHAEL STRAVATO/POLARIS



Yelp's Stoppelman spurned two rich offers in hopes of building a Net giant

Yelp If You Don't Want to Go Public

Hot tech companies are opting for private investments rather than initial public offerings

By Peter Burrows

During the boom, Silicon Valley's entrepreneurs dreamed of taking their companies public for all the recognition—and cash—that an initial public offering bestowed. But a growing number of tech's hottest startups are passing on the process, or at least delaying it indefinitely. The latest example: Jeremy Stoppelman, whose Yelp is one of the fastest-growing sites on the Web. On Jan. 28, Yelp said it would take up to $100 million from private equity firm Elevation Partners to finance growth and let employees cash in some of their stock. "It might make sense to go public someday," says Stoppelman. "If you can delay that day, there are plenty of advantages."

Three other startups have opted for similar deals in recent months—Facebook, Twitter, and Zynga, a rapidly growing games developer. What's unusual isn't that major investors want a chunk of these hotshots, but that they've agreed to spend tens of millions of dollars so cash-strapped founders and employees can pursue their visions without the pressure of public shareholders. "You've got venture guys who want out and employees who have no assets," says Lise Buyer, founder of consultant Class V Group. "This puts control back in the hands of management."

Letting entrepreneurs cash in stock used to be controversial since venture capitalists want the people they back to have every motivation to succeed. But the stance has softened as the average time it takes for a startup to go public has stretched to years, according to the National Venture Capital Assn. "You want [entrepreneurs] hungry, not starving," says NVCA President Mark Heesen.

Six-year-old Yelp attracts 29 million unique monthly visitors, who use its Web site to find member reviews of local restaurants, plumbers, retail stores, etc. The company has grown to 340 employees, most of them stuffed into a seventh-floor office in San Francisco's trendy South of Market neighborhood. Yet Stoppelman and his crew believe they've only begun to tap the potential of local online advertising. Their desire to keep control is strong enough that Yelp recently turned down a $550 million acquisition offer from Google and a bid north of $700 million from Microsoft, according to two people involved in the negotiations. "Yelp has the chance to become one of the great Internet brands," says Stoppelman. "That for me is the chance of a lifetime."

Yelp used Facebook's private equity infusion as a model for its deal. Stoppelman and Yelp director Peter Fenton from Benchmark Capital crafted terms and then negotiated with Elevation. The infusion values Yelp at $475 million. Yelp will use $25 million for company investments, while $75 million will go for a tender offer to buy a small share of each employee's holdings. That includes Stoppelman, who insists the money won't weaken management's resolve. "This isn't going to change my life dramatically," he says. "My head is still in the game." BW

TIMOTHY ARCHIBALD

WHO NEEDS AN IPO?

FACEBOOK
Last year the company received $200 million from Russia's Digital Sky Technologies, which agreed to buy $100 million more in employee shares.

TWITTER
The company received $100 million from T. Rowe Price and others so it could invest in servers and other gear to keep up with its rising traffic.

YELP
The site will get up to $100 million from Elevation Partners, three-quarters of which will be used to buy employees' shares.

ZYNGA
The social games maker got $180 million from DST in December, with an unspecified amount of that total going to cash out employees.

Lessons from the Pandemic That Wasn't

Swine flu is waning. Now scientists and health officials should be better prepared for a more serious epidemic

By Arlene Weintraub and Andrea Gerlin

The swine flu pandemic didn't turn out to be the scourge international health agencies predicted. On Jan. 29 the World Health Organization declared that even though the H1N1 virus is still spreading in parts of Europe, Africa, and Asia, the number of confirmed cases worldwide is declining. About 14,000 deaths from swine flu have been reported. That's a tragic loss, but it's a small number considering that the run-of-the-mill seasonal flu kills up to 500,000 people each year, according to the WHO.

So what have health authorities, scientists, and vaccine makers learned from the global catastrophe that wasn't? That viral outbreaks of this sort are even less predictable than scientists thought and that the defenses in place today would have been utterly inadequate against a more virulent strain. "The overwhelming expression of [H1N1] was mild," says Gregory Hartl, a spokesman for the WHO in Geneva. "Now a process has been established to help us learn."

The first priority, many experts say, is overhauling the antiquated vaccine production system. The current technology, which involves growing flu vaccines in eggs, is so cumbersome that drugmakers have to start in February to ensure they'll have enough for the following fall. H1N1 didn't emerge until April 2009, forcing the Centers for Disease Control and drug companies to scramble. There was too little of the vaccine when the virus was peaking, and too much when it started to wane. "We're very limited by this egg technology, and we've been working on the issue since 2006," says Dr. Stephen C. Redd, director of the CDC's influenza coordination unit.

MANY BOTTLENECKS

Companies and universities are racing to upgrade the approach. Baxter International, for example, tested a new cell-culture technique and was able to begin producing vaccine in just 12 weeks, once it had the virus specifications from the CDC. Baxter sold some of the vaccine in Europe and is working to get its technology approved for use in the U.S. Similarly, Texas A&M University System is breaking ground on a manufacturing research plant that will house several different vaccine-making technologies—any of which could be started up on the fly and adapted to whatever pathogen comes along.

Manufacturing is just one bottleneck. When the swine flu vaccine finally became available last fall, some doctors had no clue how much they would get or when it would arrive—if ever. Many states opted for mass-vaccination clinics, then failed to move high-risk groups such as pregnant women and health workers to the head of the line. Jeanne S. Ringel, a senior economist for the RAND Corporation who studies pandemics, was surprised by the poor preparation at the vaccination clinic near her Los Angeles home. Even though clinics were supposed to focus on priority patients, "they didn't turn anyone away," she says.



McKesson, which worked with the CDC to get the H1N1 vaccine to clinics, had just eight weeks to build a new distribution network, says Jeff Reinke, a vice-president at the company. Orders came from states through the CDC and then to McKesson—a process the company realized was too slow. McKesson tightened its packaging and shipping time lines. In an e-mail, Reinke said he welcomes the CDC's input on continuing to improve the process.

Flawed communications also stymied vaccination efforts. Many people at high risk were afraid to get the H1N1 vaccine because they thought it was unproven. In reality, it was manufactured just like the seasonal flu vaccine and tested enough to reassure



Flu vaccines are produced from viruses grown in eggs—a slow and laborious process

(BOTTOM) BEATRICE DE GEA/THE NEW YORK TIMES/REDUX



(TOP) JUSTIN SULLIVAN/GETTY IMAGES

the Food & Drug Administration that it was safe. Responding to misconceptions, the American Medical Assn. launched an educational Web site and AMA members hopped on YouTube, Facebook, and Twitter to reassure the public. Next time, consumer outreach needs to start earlier and be more aggressive, perhaps including TV ads, says Mary Anne McCaffree, an Oklahoma City pediatrician and AMA board member. "The bottom line is, we came, we saw, but I'm not sure we conquered," McCaffree says.

Some miscues came from the WHO. It initially assumed each patient would need two shots to get protection. One dose proved adequate for adults, which meant that most European countries had enough vaccine on hand to immunize all their residents. But because of confusion and public apathy, those countries ended up protecting no more than 10% of their populations.

As for vaccine makers, Morgan Stanley analysts initially predicted the three largest—Novartis, Sanofi-Aventis, and GlaxoSmithKline—would sell a combined $5.3 billion of vaccine during the six months ending Mar. 31. In a December report, they said actual sales may be as much as 15% lower. France has cut back its orders to Novartis and Sanofi. And on Jan. 26, Novartis' vaccine chief, Andrin Oswald, said 2010 sales of H1N1 vaccine would be less than half of the $1 billion the shot generated in 2009.

Vaccination clinics sometimes failed to give high-risk people priority

Even with infection rates dropping, many flu experts are concerned about some facets of swine flu. While mortality is low, children make up many of the victims. And even though next year's seasonal flu vaccine will likely include protection against swine flu, virulent new strains could emerge.

As scientists puzzle over epidemiological questions, the WHO has been accused of unnecessarily fanning public fears. One critic is Wolfgang Wodarg, a doctor and former German parliamentarian who is on the Council of Europe, an organization in Strasbourg, France, that promotes human rights. During a Jan. 26 council meeting, Wodarg accused the WHO of fabricating a pandemic that led to little more than revenues for the pharmaceutical industry. It was, he said through a translator, "dangerous nonsense."

The WHO's Dr. Keiji Fukuda, who also spoke at the hearing, defended the agency's response. Flu policies and responses recommended by WHO "were not improperly influenced by the pharmaceutical industry," he said in a statement. But, he added, "there is much to learn about how the world can improve its handling of such events." |BW|

—With Dermot Doherty and Phil Serafino

Business Exchange

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We're Not Ready

Are the surveillance systems the U.S. government uses to track diseases adequate to protect the public during a pandemic? Not exactly, conclude researchers from the RAND Corporation in an article in the journal *Disaster Medicine and Public Health Preparedness*. The authors examined six systems for disease monitoring and found shortcomings. In one case, for example, there was a three-month lag from when a safety issue affecting a flu vaccine was reported and when it was investigated. "Were a potential safety signal to be detected with the use of pandemic vaccine, several months would be far too long to provide the needed information to health officials or to reassure the public," the authors write.

To read the full paper, go to **http://bx.businessweek.com/swine-flu/reference**



Wall Street's New Flight to Risk

With interest rates at rock bottom, investors are embracing exotic bonds—and using leverage again

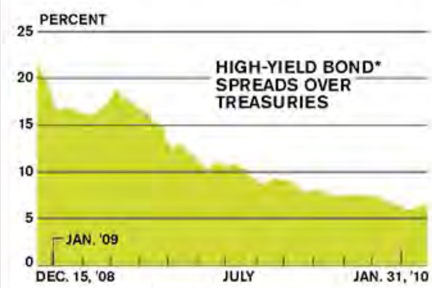
By Shannon D. Harrington, Pierre Paulden, and Jody Shenn

Even as Washington continues to rail against Wall Street for its role in the economic collapse, investors are once again turning to the kind of financial exotica that pumps up returns, and oh yes, risk. "While [risk is] not back to the eye-popping levels of 2007, investors have short-term memories," says Jason Mudrick, chief investment officer of Mudrick Capital Management in New York.

It's natural that money managers would be shedding their caution right now. The Federal Reserve has cut interest rates to the bone. Meanwhile, investors have rushed into debt markets. A record $155.3 billion poured into U.S. bond funds in 2009, according to research firm EPFR Global. All that cash is pushing down yields and raising frustration. Yields on junk bonds have fallen to 6.5 percentage points above Treasuries, from 22 points at the height of the crisis in December 2008.

THE HUNT FOR YIELD

As money has flooded the debt markets, yields have fallen



*Bank of America Merrill Lynch U.S. High Yield Master II Index
Data: Bloomberg

Hence the renewed appetite for fancy securities with alluring interest rates. After a two-year hiatus, "payment-in-kind" bonds are making a comeback. The bonds, which allow cash-strapped borrowers to issue more debt to make their interest payments, helped fuel the private equity dealmaking frenzy when times were good. Hedge funds and other investors have picked up $1.85 billion of them since late last year. Johnson-Diversey Holdings sold $250 million of the bonds in November. The cleaning supply maker will be able to use cash or debt to pay its 10.5% interest for five years. Three weeks later, Wind Acquisition Holdings Finance, parent of Italy's third-largest mobile-phone company, raised $1.1 billion under similar terms. There was such demand that Wind Acquisition upped the size of its offering by 50%. "Six months ago I wouldn't have imagined being able to do this deal," says Karim-Michel Nasr, head of corporate development at Weather Investments, Wind's holding company. "It's an issuer's market."

The upside for companies is that they can conserve cash during lean times. But they also keep piling on debt. If a business ultimately goes bust, creditors will face even larger losses.

That is what's worrying investors who bought similar bonds back in the good old days, three years ago. In October 2007, buyout firms KKR and TPG paid $43 billion for TXU, the Dallas-based company now known as Energy Future Holdings. The electricity provider sold $4.25 billion of payment-in-kind bonds to help finance the deal, the largest private equity takeover in history. Energy Future has made

ILLUSTRATION BY ALEX NABAUM

some interest payments with debt and currently owes $4.75 billion on the securities. The bonds are trading at less than 77¢ on the dollar, according to Trace, the price reporting system of the Financial Industry Regulatory Authority. Lisa Singleton, an Energy Future spokeswoman, says the debt allows the company to maintain liquidity and increase financial flexibility.

Recent bond buyers say they're being cautious, paying close attention to the fundamentals. "Is it the early signs of froth and excess?" says William Cunningham, global head of credit strategies and fixed-income research at State Street's investment unit. "Not when you look at the numbers."

Then there are derivatives. Some banks are again pushing the simplest forms of synthetic collateralized debt obligations that bet on the severity of corporate defaults. Morgan Stanley and Bank of America strategists recommended such investments to clients in December. "Most people we speak with are taking a very cautious approach," says Sivan Mahadevan, a Morgan Stanley derivatives strategist. "What you don't want is for investors to jump in indiscriminately." While the banks say such instruments help companies raise capital, former Federal Reserve Chairman Paul Volcker has blamed complex derivatives for taking the financial system to the "brink of disaster."

Leverage is also on the rise. Investors who buy mortgage securities backed by jumbo home loans now can borrow as much as $10 for every $1 in capital, amplifying returns. While a healthy economy needs some leverage, there's a dark side. As asset values plunged in 2007 and 2008, hedge funds that relied on borrowed money were forced to dump holdings or were wiped out altogether, such as London-based Peloton Partners. "I've got to be honest, leverage coming back this quickly is a little frightening," says Jim Shallcross, who oversees $12 billion in bonds at Declaration Management & Research in McLean, Va. "You can't assume everybody is going to do stuff rationally." |BW|

–With Bryan Keogh, John Glover, and Tara Kalwarski

Stretching Every Rupee

India is grappling with its worst inflation in a decade

By Bruce Einhorn and Cherian Thomas

Movie night and restaurant meals are out for Vinod Kumar. As prices for sugar, onions, and other staples have surged after poor monsoon rains damaged harvests, Kumar has been forced to cut back to keep food on the table for his family of four. "It's never been so bad in my working life," the 35-year-old mechanic says as he shops at Bangalore's Johnson Market, a century-old tangle of food stalls.



RAVEENDRAN/AFP/GETTY IMAGES

A drought has sent food prices spiraling at markets across India

It's not just food that's getting more expensive. Inflation in India is at a decade high, with consumer prices rising faster than in any other major economy. Industrial output in January increased at the fastest pace in 17 months, pushing up prices for raw materials. Cotton has jumped by 13% since October, while other commodities are rising fast. The benchmark wholesale price index, up 7.3% in December, could hit double digits within two months, predicts brokerage CLSA. That would spur even higher consumer prices and dent the spending power of ordinary Indians.

India's central bank governor, Duvvuri Subbarao, is trying to cool things down. To lower the amount of capital available for lending, the Reserve Bank of India on Jan. 29 increased the cash reserve ratio for banks (the minimum they have to keep on hand) by 0.75 percentage points, to 5.75%. Tighter interest rates are probably next. The bank has moved from "managing the crisis to managing the recovery," Subbarao told reporters on Jan. 29.

Despite India's thriving tech sector, it remains beholden to the vagaries of the monsoon. Less than half of India's fields have irrigation, so a drought last summer led to food shortfalls in several states. Poor railroads and highways make it tough to transport food, leading to shortages and higher prices in many cities. "You don't have enough roads, you don't have enough railroads, you don't have enough ports," says Nikhilesh Bhattacharyya, an economist with Moody's Economy.com. "That amplifies any price shock."

Rising prices are a big headache for Prime Minister Manmohan Singh. In the past 15 years, Indians have ousted two national governments after inflation eroded spending power. Higher interest rates will make it harder for companies to expand, and with the budget deficit at a 16-year high, the government can scarcely afford to boost spending on infrastructure. Indian companies meanwhile, fear higher labor costs. "The rise in food prices will have a cascading effect," says M.S. Unnikrishnan, managing director of Thermax, a Pune-based maker of heating and cooling equipment. "We can't keep paying people the same amount if their cost of living is increasing." |BW|

–With Natalie Obiko Pearson

What's More Golden Than Gold

While many metals have lost their luster, platinum and palladium are poised to shine this year

By Steve LeVine

Gold is nice, but nothing says "I love you" like platinum. That's not some Valentine's Day pitch from a jeweler. While last year's rally in metal seems to have petered out, prospects for platinum, along with palladium, remain bright. Used mainly in catalytic converters that curb the smog emissions of vehicles, platinum and palladium chalked up price increases of 56% and 117%, respectively, in the 12 months ended Nov. 30. Analysts believe prices could go higher still this year, thanks to the Jan. 8 launch of two U.S. exchange-traded funds that make direct purchases of these metals, thereby influencing their price. The funds booked $486 million in investments in three weeks of operation. "The potential growth is huge," said Suki Cooper, an analyst with Barclays Capital.

The upside in other precious metals may be more limited this year. Gold and silver rose 24% and 50%, respectively, over the 12 months ended Nov. 30 as investors sought refuge from the global economic crisis. But prices have since retreated as the dollar strengthened.

This year's losers are likely to be so-called base metals. Copper and zinc, for instance, were up 139% and 112% in 2009 on expectations that stimulus spending would spur demand for industrial raw materials. But prices reversed course in January as governments moved to curb spending. Forecasts for these metals are all over the map. There is consensus on one point, though: The strength and speed of the recovery—particularly in places like China and Brazil—will be the main driver of prices this year. |BW|

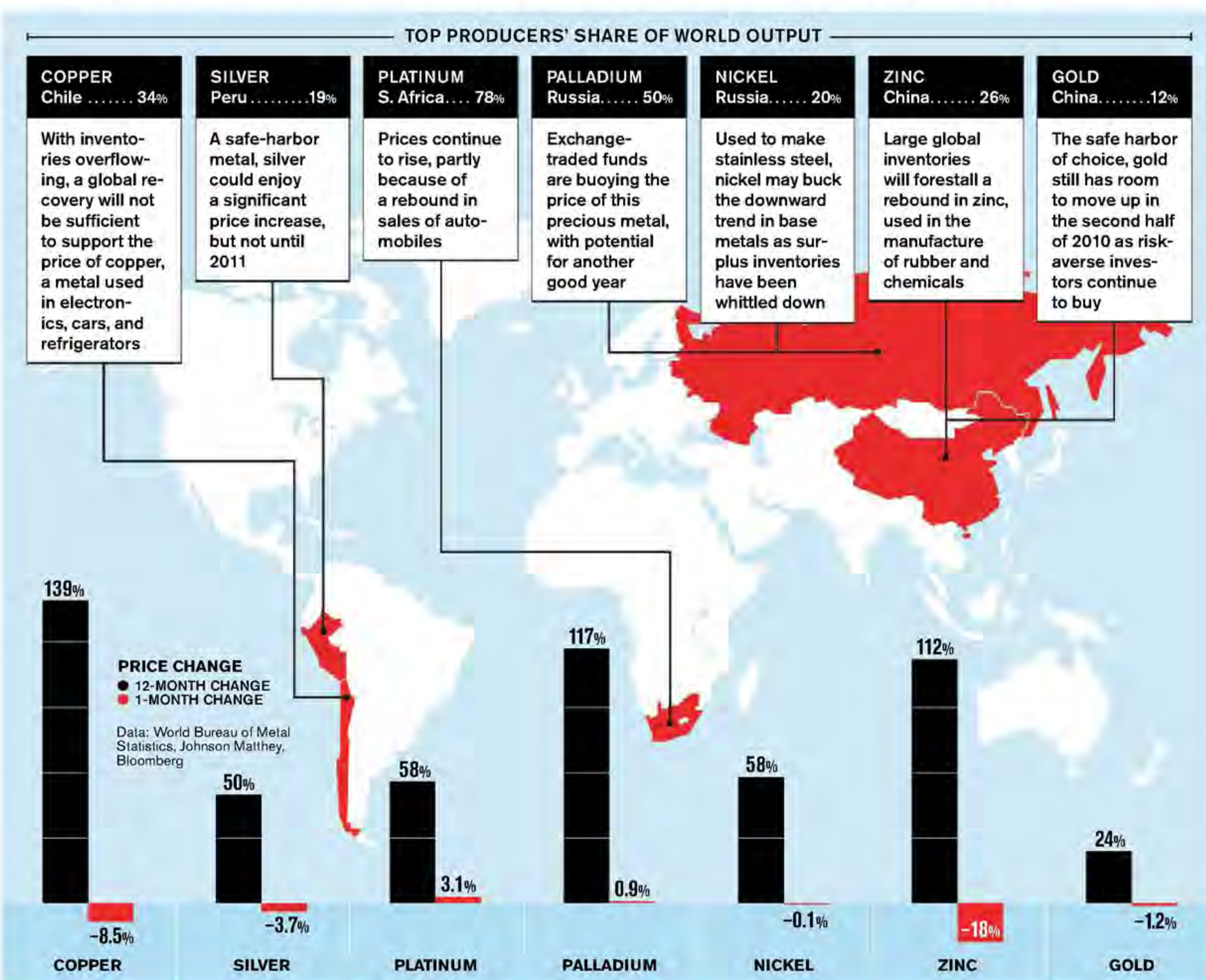


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Berlusconi vs. Murdoch: Porn as a Pawn

Rules that limit adult programming are just one way Italian regulators are helping Silvio and hurting Rupert

By Carol Matlack

Two contestants battling over a jackpot worth billions. Political intrigue and a dash of X-rated spice. Nope, it's not a reality show. It's a clash between media titans Rupert Murdoch and Silvio Berlusconi for supremacy in Italian TV.

The brawl pits Murdoch's satellite pay-TV outfit Sky Italia against Mediaset, the country's dominant private broadcaster, founded by Berlusconi long before he became Prime Minister. Since its launch in 2003, Sky Italia has become a formidable rival, offering everything from Hollywood blockbusters and sports to porn.

Lately, Sky Italia has been struggling. Although it has more than 4.7 million subscribers and controls about 90% of the Italian pay-TV business, the company on Feb. 2 said that during the fourth quarter it lost $30 million and shed 63,000 customers, its first-ever net subscriber loss.

Regulators are adding to Sky Italia's woes. Last year the Berlusconi government doubled the value-added tax on pay TV. That raised the cost of a Sky Italia subscription by 10% but didn't affect Mediaset's over-the-air service. Starting this winter, regulators plan to cut the ads allowed on pay TV from a maximum of 18% of airtime to 12% in 2012. Broadcast channels such as Mediaset's, meanwhile, will be permitted to boost ads to 20% of airtime from 18%. Regulators say broadcasters need advertising more than pay-TV providers because they don't get subscription fees. And in January the government said it would ban adult programming between 7 a.m. and 11 p.m. to keep children from seeing porn. Sky is Italy's biggest purveyor of X-rated TV, reaping $62 million a year from such fare.

The avalanche of new regulations has Sky Italia crying foul. The company says its parental controls keep kids away from adult programming. And the ad limits would squeeze the company's fastest-growing revenue source, Sky Italia Vice-President Andrea Scrosati told reporters in Rome on Jan. 26, after testifying against the restrictions before a parliamentary committee. "There was no need to interfere in the classic process of supply and demand."

LURID REPORTING

The two camps have been sparring for months. Berlusconi has accused the *Times of London*, owned by Murdoch's News Corp., of lurid reporting on his private life in retaliation for the pay-TV tax hike. "Unfortunately with the VAT episode there was a breakdown in relations with the Sky group," the Prime Minister said on a Mediaset channel last summer. Berlusconi remains Mediaset's controlling shareholder, though he has handed over management to his son. In September, Sky Italia sued Mediaset after it refused to accept Sky's advertising. An Italian court in October ruled that Mediaset had violated competition laws to help Mediaset Premium, a pay-TV business it launched in 2005. Mediaset didn't respond to requests for comment.

Mediaset Premium may be Sky Italia's biggest problem. The service added some 700,000 viewers last year, says Claudio Aspesi, an analyst with Bernstein Research. Mediaset Premium used to concentrate on pay-per-view soccer but now offers broader programming, including the Disney Channel and big-studio films. "They have found ways to fight back," Aspesi says. With few ads and no porn channels, Mediaset Premium won't suffer much from the recent rule changes.

Could Murdoch still win? He has potential allies, including ESPN and the Discovery Channel, which run programming on Sky Italia and will be hurt by the ad limits. And Berlusconi can't rule forever. But James Walston, a political scientist at the American University of Rome, says the odds favor Mediaset. "Berlusconi is fighting from an entrenched position," he says. "Murdoch will have to fight through European regulators and the Italian courts. That could take a decade." |BW|

–With Steve Scherer in Rome

HARRY CAMPBELL

Reading Keynes In Tehran

A group of Iranian executives is determined to build a modern B-school for their country

By Stanley Reed

Most Saturday mornings a small group of Iranian professionals and entrepreneurs gathers either in a small office on London's New Bond Street or in a Tehran villa to talk about a school that doesn't exist yet. This fall, though, after two years of planning, they hope to open Iran's first modern business school, an event they hope will boost their country's development.

The Iranian Business School Project has hired a dean (who for personal reasons asked not to be identified) and, despite Iran's turmoil, intends to offer executive education courses starting in October. A full-fledged master's program would follow in two to four years. Iran has a dozen other B-schools, but this one will be designed to meet the standards of the world's best management programs. "If Iran is going to have any role in the global economy, it needs people who can manage companies," says Rouzbeh Pirouz, a London and Tehran-based entrepreneur and the project's chairman.

Pirouz, 37, is one of the few Iranians to run successful firms in his country despite the red tape and isolation that burden businesses there. Born in Tehran, Pirouz left with his family at the time of the 1979 revolution. He grew up in Vancouver, British Columbia, earned a college degree at Stanford, and went on to Oxford as a Rhodes Scholar—where, in 1999, he co-founded Mondus, a Web procurement company for small business, which he later sold to Telecom Italia for $350 million.

Looking for his next act, Pirouz found himself drawn back home despite the warnings of friends that Iran was a bad place for business. In 2005 he started Turquoise Partners, which manages a stock fund as well as a private equity unit. Turquoise, with more than $100 million under management, offers outsiders a rare chance to invest in the Iranian stock market. In the 12 months through Dec. 31, Turquoise's Portfolio One fund returned 18% in dollar terms. In setting up the funds, Pirouz showed deftness in handling the regime while keeping his employees and colleagues fired up for the venture. "Rouzbeh," says Katy Palizban, a member of the project's board and a former Goldman Sachs banker, "has an incredible ability to inspire loyalty."



Pirouz has shown deftness in dealing with the Ahmadinejad regime

JUDE EDGINTON/REDUX

Much of the Iranian economy remains in the hands of the state. But Pirouz believes that over time the country's pragmatic side will assert itself. He points to the stock listings of state businesses, including Telecommunications Co. of Iran and the giant Mobarekeh Steel Complex. As for President Mahmoud Ahmadinejad, the school has obtained a letter of support from a presidential aide. Pirouz also lured some top names in Iranian business to the school's board, including Parviz Aghilli, founder of one of Iran's few private banks.

Iran's existing business schools can't meet all the country's needs. They have room for only 500 students, which means too many top applicants get turned away. Many of those who do get MBAs end up leaving the country, contributing to Iran's brain drain. The curriculum of the existing B-schools doesn't offer the latest thinking in such subjects as strategy, finance, career development, and succession planning.

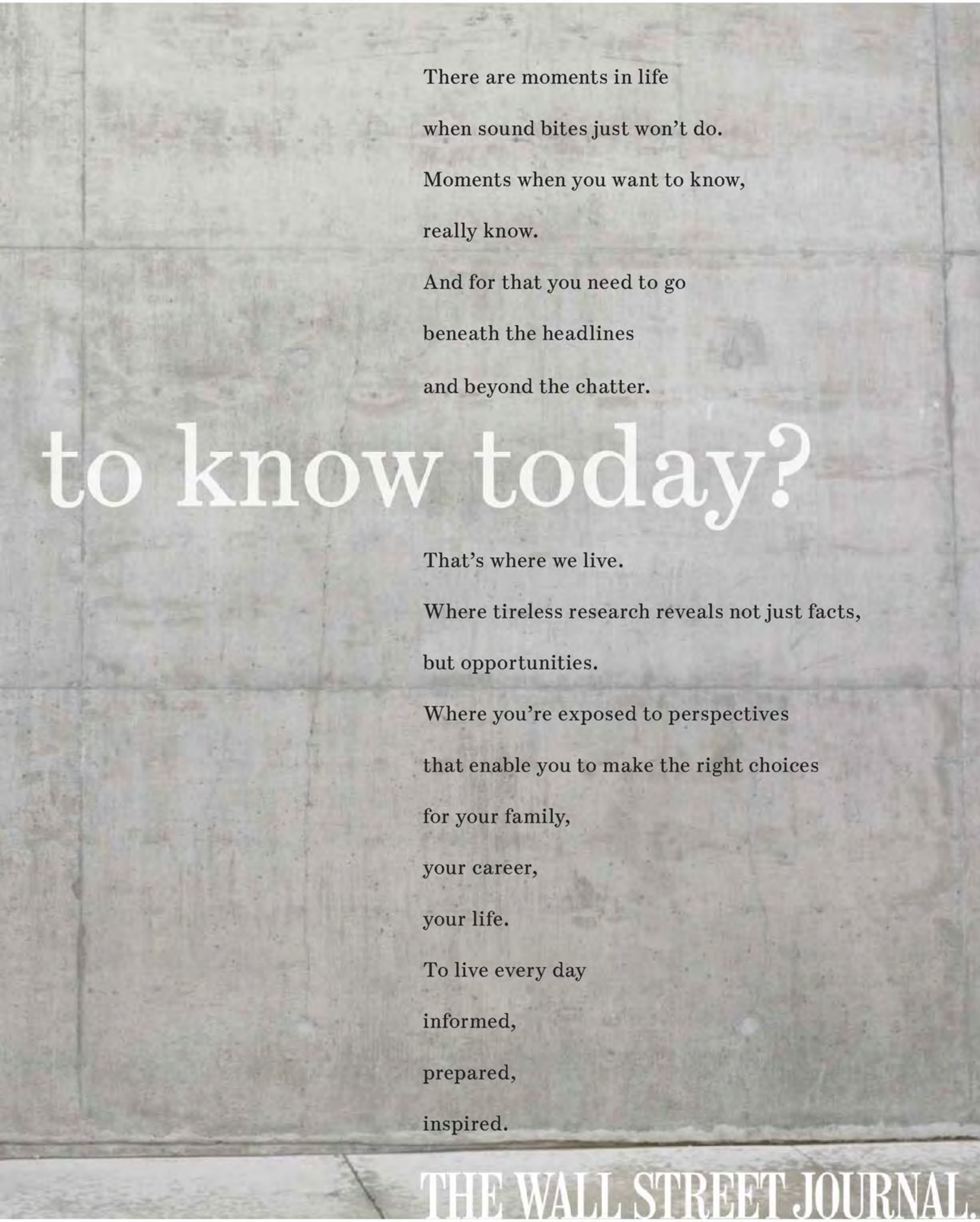
The new school will greatly expand Iran's pool of business graduates by offering places for 250 students in each class. It plans to hire faculty from the West and in some subjects will employ the Harvard case-study system. One model, according to Michael Hay, a London Business School professor and special adviser to the project, is the decade-old Indian School of Business in Hyderabad, which taps the wealth of overseas Indians and recruits faculty from the many Indian B-school professors working abroad.

The project has been a tough slog. A year ago the founders thought the school might end up in a small town on the Caspian Sea after learning that no new licenses were available for schools in Tehran. Eventually the Tehran license came through. Crisis averted. There are sure to be others, though, before class is in session. |BW|

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live in the know



AT&T'S iMESS

By Roben Farzad

Illustration by Matt Mahurin

The iPhone has swamped its data network and sparked a consumer rebellion. What can Ma Bell do?

In mid-December, Fake Steve Jobs, the alter ego of widely read journalist and blogger Dan Lyons, posted the following appeal to his fellow members of iPhone Nation: "On Friday, Dec. 18, at noon Pacific time, we will attempt to overwhelm the AT&T data network and bring it to its knees. The goal is to have every iPhone user (or as many as we can) turn on a data-intensive app and run that app for one solid hour. Send the message to AT&T that we are sick of their substandard network. ... Join us and speak truth to power!" Soon thousands of hooligans—or if you prefer, frustrated customers paying AT&T as much as $150 per month—took to Twitter and Facebook to join up.

Operation Chokehold might have been a landmark consumer uprising had the federal government not stepped in. Two days before the planned protest, Jamie Barnett, the Federal Communications Commission's chief of public safety and homeland security, issued a statement warning that to "purposely try to disrupt or negatively impact a network with ill-intent is irresponsible and presents a significant public safety concern." Doing so could interfere with 911 calls. Fearing a boomerang of negative publicity, the Chokeholders called off the stunt, but the popular backlash against AT&T raged on. On the Dec. 20 broadcast of NBC's *Saturday Night Live*, Weekend Update anchor Seth Meyers noted that Google's new phone might pose a threat to Apple's iPhone and added: "Also a challenge to the iPhone: making phone calls."

AT&T has stumbled into a quagmire. When it secured exclusive rights to support Apple's iPhone on its wireless network in June 2007, investors hailed the deal as a masterstroke. Here was stodgy, safe AT&T positioning itself to gulp profits




11:59 AM

THE TRUTH ABOUT BANDWIDTH

Wireless operators are struggling to keep up with demand as more people use their phones to check Facebook and watch videos online. Here are estimates of how much bandwidth is used per person for various activities on different phones.

One megabyte is roughly equivalent to one digital book, 45 seconds of music, or 20 seconds of medium-quality video.



FEATURE PHONES

Phones such as the Motorola Razr are used primarily to make calls, and they consume little bandwidth even for Web activities because they have stripped-down Web browsers.

Voice Calls: 4 MB per hour

Web Browsing: 4 to 5 MB



SMARTPHONES

Smartphones such as Research In Motion's popular BlackBerry are used for phone calls, e-mail, and light Web browsing.

Voice Calls: 4 MB per hour

Web Browsing: 4 to 5 MB



SUPERPHONES

Advanced smartphones, including Apple's iPhone and Motorola's Droid, make it easy for people to surf the Web and watch online videos, leading to much higher bandwidth use.

Voice Calls: 4 MB per hour

Web Browsing: 40 MB

Net Radio: 60 MB

YouTube Videos: 200 MB

MONTHLY TOTALS*

100 MB

185 MB

560 MB

*Estimated Data: Chetan Sharma Consulting

from a cutting-edge technology. But AT&T and Apple vastly underestimated the iPhone's appeal. At launch, Real Steve Jobs said he'd be happy if the device could grab 1% of the global cell-phone market, or about 10 million units for 2008. Instead, Apple has sold at least 42.4 million—25.1 million in 2009 alone, 14% of the global smartphone market. AT&T, which markets the iPhone in the U.S., simply can't handle the traffic.

Making matters worse is the proliferation of "apps," those bandwidth-sucking programs that make smartphones so much smarter (table). According to Apple, iPhone users have downloaded at least 140,000 different apps a total of 3 billion times. Watching broadcasts of Major League Baseball games and studying the globe via Google Earth on a palm-size device feels like a promise from the future, but the networks delivering all this data are still just catching up with the present. "We expected this was going to open up a new level of engagement, and we knew we'd be successful in the market," says AT&T Operations President John Stankey. "We missed on our usage estimates." Case in point: It's not atypical, he says, for 80% of a college football crowd to be using their iPhones.

The rise of iPhone Nation—with its media-savvy and data-greedy citizenry—has left AT&T with a tough set of options. It could significantly upgrade its network to handle all the new demand, but that would cripple profits. It could charge more for network access or limit what customers can do on their phones, but that would enrage the all-you-can-eat subscriber base as well as Net Neutrality types who seek to prevent telecom companies from dictating customers' options. It could permanently halt iPhone sales in overcrowded markets, but that would bring more mockery, not to mention place AT&T in the unusual position of denying consumers access to a product it doesn't even make.

To keep its uneasy equilibrium, AT&T is trying a little of everything: It's marginally increasing capacity while trying to squeeze network hogs and subtly reshape the definition of Net Neutrality.

BLOWING KISSES

So far the gambit has paid off. On Jan. 28, AT&T said its fourth-quarter profit had risen 26% from 2008 and that it had added 7.3 million wireless customers in 2009, equaling its most ever in a single year. What's more, Apple hasn't lost faith; when it unveiled its iPad tablet PC in January, it said it had given AT&T the exclusive right to provide data service. But this time Apple has stipulated that AT&T can't lock customers into service contracts for the iPad, making it easier for them to bail if another carrier starts offering service.

That's where rival Verizon comes in. The New York-based carrier has been blowing kisses to iPhone users for months, signaling that it's ready to serve them as soon as Apple wants to make a deal. Verizon is already racing ahead of AT&T in upgrading its slow copper wires to fast fiber-optic lines



TABLET COMPUTERS

Devices such as Apple's newly unveiled iPad are likely to send data use even higher. The iPad will chew up even more bandwidth than the iPhone because of its larger screen.

Web Browsing: 50 to 60 MB per hour

Net Radio: 60 MB

YouTube Videos: 300 to 400 MB

800 to 1,000 MB

that carry FiOS, its bundle of telephone, Internet, and television services. By contrast, AT&T's competing U-Verse service, which runs over a patchwork of fiber-optic and copper wires, has gained little traction. The iPhone was supposed to be the great equalizer for AT&T, but since the launch in 2007, AT&T's stock has underperformed Verizon's by 12 percentage points and the Standard & Poor's 500-stock index by six.

For AT&T CEO Randall Stephenson, managing one division for growth and another for costs is "a delicate and very tricky balance," says Zhiping Zhao, a telecom specialist with New York-based research firm CreditSights. "And if AT&T doesn't find that balance, it doesn't grow." Adds Gerard Hallaren, director of research at TownHall Investment Research in Littleton, Colo.: "It's a juggling act."

AT&T says the usage issue is broader than one company. "I don't think there's been any significant shift in consumer technology that hasn't come with growing pains," says Stankey. "Think back to America Online and busy signals. It's not that these problems can't be solved—it's that mobile is a different game."

MA BELL IS BACK

Today's AT&T, with nearly 300,000 employees and annual sales of $124 billion, is in some respects a remarkable turnaround story. After the historic dissolution of Ma Bell in 1984, Southwestern Bell (SBC), one of the seven regional Bells created after the breakup, spent a quarter century reassembling broken-off pieces under the stewardship of deal-happy CEO Ed Whitacre (now chief executive of General Motors). By 2006, having rolled up four of the original Bells and the remains of AT&T proper, SBC rechristened itself AT&T and returned to using the iconic stock symbol T (for telephone).

Ma Bell was back. Then came the iPhone and its array of network-sapping apps. Wireless profits soared, but at a cost. In December AT&T Wireless said 1% of smartphone customers accounted for 20% of the data drain on its network, while its top 3% were using up 40%. Several recent surveys, including those by *Consumer Reports* and research firm Yankee Group, have placed AT&T last in customer satisfaction among major carriers.

When AT&T suggested in December that some customers were using too much bandwidth, it failed to anticipate the backlash that would follow. Business schools are littered with case studies of companies that have paid the price for insensitivity to customers' wishes. (New Coke, anyone?) The perils have only increased in an era when it's easy to make complaints heard globally. Apple, for one, had to deal with its own customer-service crisis in 2003 when brothers Casey and Van Neistat of New York discovered that their iPod batteries were irreplaceable and lasted just 18 months. They made a film called *iPod's Dirty Secret* and launched a protest Web site that drew millions of hits, after which Apple addressed the problem. And following the success of *Super Size Me*, in which documentarian Morgan Spurlock chronicled his decline in health while eating meals only at McDonald's for 30 days, the fast-food chain did away with its Super Size meal option. Companies from PepsiCo to Facebook have also discovered the power of consumers in changing everything from products to privacy policies. A 2009 study by Keller Fay Group in New Brunswick, N.J., found that only 22% of conversations about a brand refer to the company's advertising. Says customer service consultant Jeanne Bliss: "The marketing message is no longer under a company's control. We trust other customers first."

The most vulnerable targets are often companies such as AT&T that have an ongoing relationship with their customers. Locked in by long-term service contracts and powerless over everything from network failures to wait times for reaching a human being in customer care, subscribers are easily frustrated. "The telecom industry has been a laggard relative to other industries on the customer-service front," says Macklin Martin, director of consulting at International Customer Management Institute in Colorado Springs. He points to the high costs of maintaining the network and customer support, combined with intense competition, as factors. "It's a difficult business model to maintain," Martin says.

Among the angriest customers is John Rust, a freshman at Patrick Henry College, a Christian school in Purcellville, Va. Rust is one of the Three Musketeers, a splinter group formed from the Operation Chokehold campaign for the purpose of pestering AT&T. Outside class, the soft-spoken, polite 19-year-old—he closes his e-mails with "Blessings"—works as a video editor and Web designer for a local film company. After purchasing an iPhone in September 2008, Rust says, he quickly became frustrated with the numerous dead spots and poor service quality on AT&T's network. "Unlimited should be unlimited," he says. "When I bought my iPhone, I signed a contract with AT&T. They haven't upheld their end of the

"I DON'T THINK YOU CAN HAVE AN UNLIMITED MODEL FOREVER," SAYS AT&T'S STANKEY. "MORE PEOPLE GET DRUNK AT AN OPEN BAR THAN A CASH BAR."

(IPAD) COURTESY APPLE



In December, Alix filed a complaint against AT&T over problems with its landline network

bargain. Simply put, I want what I'm paying for." AT&T's Stankey says: "I don't think you can have an unlimited model forever with a scarce resource. More people get drunk at an open bar than a cash bar."

When Rust joined Operation Chokehold, he linked up with pals Dylan Pine of Nashville and Peter Serven of St. Louis via social networking. Serven started a Facebook group and reserved Twitter usernames and domain names related to Chokehold. Within a few days, thousands of users had joined. The Musketeers put together a central site, drafted marketing material, and traffic-copped their Facebook and Twitter pages. In the final 24 hours before the planned operation, the Musketeers were featured on CNN. Rust says he isn't finished. He and the Musketeers are working with developers to create an online mapping service (and possible iPhone app companion) that lets users post AT&T dead zones and poor service areas for everyone to see. Also on tap: organizing "flash mobs" to picket AT&T Wireless stores. All three say they're eagerly awaiting a Verizon iPhone.

Musketeers, Chokeholders, and other critics want AT&T to spend to improve its network. Wireless is by far its fastest-growing division, contributing 44% of total revenue in 2009, up from 36% in 2007. But overall capital spending hasn't kept pace, falling from $20.3 billion in 2008 to $17 billion last year. AT&T vowed in January to boost 2010 wireless spending by as much as $2 billion. "We think it's a start, but not much more than that," says TownHall's Hallaren, who contends that AT&T would have to spend $5 billion to $7 billion to bring its network up to Verizon's quality. AT&T rejects an apples-to-apples comparison with Verizon. "For someone to sit outside our business and try to derive a relative investment value—I can't imagine anyone trying to do that," says Stankey.

Even if AT&T were willing to boost its wireless network investment significantly, figuring out precisely how much to spend without sacrificing profits would be hard. Craig Moffett, a telecom analyst at Bernstein Research, has analyzed various scenarios. His findings: If AT&T were to triple its capital spending on wireless, the value of an iPhone customer to the company would be halved. A sixfold increase in spending would make all iPhone customers worthless to AT&T. Stankey disputes Moffett's conclusions but agrees with "the thought process that we need a return on capital."

LIMITING ACCESS

Instead of betting big on new investment or aggressively raising prices, AT&T is choosing a controversial third way: It's trying to limit the iPhone features customers can use. The company prohibits Webcasts and file sharing on its unlimited data plans, activities some other carriers allow. "We need to be able to manage our traffic," says Stankey. "You can't have everybody watching YouTube during an emergency." The Net Neutrality movement disagrees with that reasoning. "We're at a critical moment," says Ben Scott, policy director of Free Press, a nonpartisan group that argues telecom providers should have no ability to limit their customers' network access. "Do we as a country invest in bandwidth, or the network tools to limit bandwidth?"

AT&T also takes a hard line on iPhone "tethering," the process by which users hook up a computer to a smartphone to gain Net access. Most carriers allow tethering for a small fee. AT&T does, too, but not for the iPhone; instead, iPhone customers who want laptop Net access must pay at least $40 a month for a separate mobile laptop device and data account. Mackay Bell, a 39-year-old freelance writer in Los Angeles, says he's "pissed off" that AT&T won't let him tether. "It's ridiculous that I should have to get a USB toggle and pay so much extra," he says. His blog, at attcritic.blogspot.com, features the AT&T logo as Dr. Evil from the Austin Powers movies. Bell says he would jump at the chance to have a Verizon iPhone. AT&T says it plans to offer iPhone tethering, but for now, says Stankey, "You don't want to throw more gasoline on the fire."

The Mackay Bells of the world wouldn't be so worrisome for AT&T were its once-mighty landline business still strong. But Bernstein estimates that the unit's profit margins will fall



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Rust, a student in Virginia, uses social networking to plan consumer protests

STEPHEN VOSS

from 32% today to 26% in three years, which translates to a $3.6 billion plunge in that segment's operating income. Like the rest of the telephone industry, AT&T is being hit hard by the growing share of households opting for only cell phones. It also has been buffeted by competition from cable companies, which bundle phone service as part of their phone, Net, and TV packages. Upgrading phone lines to compete with cable companies isn't cheap. FiOS has gone from zero customers to 3.5 million in five years—but to get there, Verizon is investing more than $23 billion in fiber-optic wires.

FRAYING LANDLINE

Given the economics of landline telecommunications, it's little wonder AT&T hasn't made a market-altering investment in its U-Verse service. The company hasn't divulged how much it has devoted to date, but says it has invested less than half of what Verizon has spent per customer home. CreditSights' Zhao places the total U-Verse investment in the vicinity of $10 billion. AT&T concedes that it won't be rolling out U-Verse to 100% of its homes and will opt instead to resell third-party satellite television in the homes it isn't rewiring. "Instead of bundling a good value proposition to keep customers away from the cable triple play, they adopt half-baked solutions," says Zhao. Bruce Kushnick, chairman of TeleTruth, a consumer-advocacy group, calls U-Verse "a cheap copper afterthought" and faults AT&T for neglecting its still substantial number of landline-only households. Says Stankey: "We're having an awful lot of success for something that's an afterthought."

Not all the feedback has been positive. Adam Alix, 20, is a Northeastern University student whose parents in Connecticut say they've had chronic sound problems with U-Verse and are considering switching to cable. In December, Alix filed a complaint on their behalf with Connecticut's Public Utilities Control Dept. and on Jan. 4 sent a letter to State Attorney General Richard Blumenthal. "What was most unsettling to me was that AT&T never seemed to listen to what I had to say, never acknowledged that the fault lay with them instead of with our hardware and wiring, and that they wasted so much of my time," says Alix.

Yet AT&T can't afford to redouble its landline efforts now, because a bigger war is flaring up in wireless. For years Verizon had resisted cutting its wireless prices, but on Jan. 15 it slashed the monthly rate on its unlimited calling plan from $99.99 to $69.99. AT&T quickly matched the offer for all its cell phone products, even the iPhone. The upshot? An iPhone customer who had been paying $149.99 a month for unlimited calling, Web-browsing, and text service now pays just $119.99. "We obviously want to remain competitive," says AT&T Wireless spokesman Mark Siegel.

With customers in open revolt, AT&T's definition of "competitive"—modestly lowering prices and raising investment spending—might not be enough to stave off Verizon. "I'm not aware of any company in this country that has had so aloof a stance toward quality of service," Rich Doherty of The Envisioneering Group, a Seaford (N.Y.) telecom market research firm, says of AT&T. "And that's after two and a half years of fronting the world's most elegant and entertaining handheld data device."

Maybe losing some customers to Verizon wouldn't be the worst thing for AT&T. Its data network could use a breather. And AT&T wouldn't mind seeing Verizon strain under the weight of iPhone Nation. Soon after Operation Chokehold hit the blogosphere, Verizon signaled that it was ready for Apple's business. Sure about that? | BW |

–With Arik Hesseldahl and Diane Brady

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iNeed You, AT&T

It wasn't all oohs and aahs during iPad's introduction. There were also groans when news broke that AT&T would be the official service provider for Apple's much anticipated tablet computer. But a Jan. 27 article in *PC Magazine* argues that Steve Jobs has five good reasons to stick with AT&T. Here's one: GSM, the technology used by AT&T, is the most prevalent standard worldwide and is therefore key to Apple's international expansion plans. Another: Verizon, which is AT&T's main rival, has been supplementing its own lineup of smartphones with additions from Android and Palm. So the carrier could probably do without the spike in data traffic that a host of iPad users would bring.

To read the *PC Magazine* story, go to **http://bx.businessweek.com/apple/reference/**

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THE MAN WITH THE MEANEST BANK SHOT



By Peter Coy

Photograph by Dana Smith

Boston University economist Larry Kotlikoff wants to take all the risk out of banking. Some people are listening

The publishing world is too slow for Laurence J. Kotlikoff. On a frigid January day, the 58-year-old Boston University economist is pecking away at his computer keyboard in his airy office overlooking the Charles River. Kotlikoff's forthcoming book, *Jimmy Stewart is Dead*, calls for a radical—and swift—reorganization of the financial system. So rather than wait for the book's Feb. 22 publication date, Kotlikoff is e-mailing PDF versions to dozens of economists, journalists, and policymakers. "We have miscreants running the financial system left, right, and center," says Kotlikoff. "Nobody is calling the [Obama] Administration to task and saying, 'You guys are putting a Band-Aid on cancer.' "

Kotlikoff would drain the risk-taking out of commercial and investment banks, hedge funds, and insurance companies—turning them into boring, narrow intermediaries akin to mutual-fund firms. Instead of taking deposits and making loans, banks would connect borrowers and depositors with ultrasafe mutual funds created for those purposes. That would solve the problem of banks not keeping enough money in their vaults to pay depositors if they all wanted their money at once, a flaw vividly demonstrat-

Kotlikoff, always outspoken, says the U.S. financial system is run by "miscreants"



ed to George Bailey, the character played by Jimmy Stewart in *It's a Wonderful Life* (hence the title of Kotlikoff's book).

Kotlikoff sounds so unrealistic that, like George Bailey, he could use a guardian angel to set him straight. But he's beginning to catch the attention of powerful policymakers and the economists who have their ears. In Kotlikoff's biggest coup yet, Bank of England Governor Mervyn King—Britain's counterpart to Federal Reserve Chairman Ben Bernanke—urged members of Parliament to study the plan. In the U.S., Kotlikoff's "limited-purpose banking" idea is finding support among economists across the political spectrum, including University of Chicago Nobel laureate Robert Lucas on the right and Columbia University's Jeffrey Sachs on the left.

People who know Kotlikoff no longer marvel at his zeal. "Being Larry's friend is not for sissies," says Perry Mehrling, an economist at Columbia's Barnard College, borrowing a line famously used about the hyperkinetic economist and Nobel winner Franco Modigliani. Kotlikoff attributes his drive to what he calls a healthy inferiority complex. "I never thought I was the smartest guy in the world," he says.

A LEAP TO BANKING

Kotlikoff grew up with a twin brother and older sister in Pennsauken, N.J., near Philadelphia. Starting at age eight, he helped wrap packages during the Christmas rush at Kotlikoff's, the family-owned department store in Camden. He credits a high school teacher for rescuing him from the "dummies track" in math with a summer of free private tutoring. The extra work helped him get into the University of Pennsylvania, from which he graduated with a degree in economics in 1973. Next came Harvard, where he earned a PhD in 1977. After brief teaching stints at UCLA and Yale and a job in the Reagan White House, he landed at Boston University in 1984 and hasn't moved since, twice serving as department chairman.

Kotlikoff is not shy with his opinions. In *The Coming Generational Storm*, published in 2004, he and *Dallas Morning News* columnist Scott Burns advocated turning Social Security into personal retirement accounts. He backs replacing the federal income tax with a national sales tax. He served as economic adviser to the 2008 Presidential campaign of antiwar candidate Mike Gravel, who switched from the Democratic Party to the Libertarian Party in mid-campaign. And in his spare time? He runs a personal-finance software company called ESPlanner that helps people model retirement-saving strategies.

HE INSISTS THAT ALL THE ADMINISTRATION IS DOING IS "PUTTING A BAND-AID ON CANCER"

Jimmy Stewart Is Dead is something of an intellectual leap for Kotlikoff because his expertise is in public finance, not banking. He says he thought of writing the book when he saw an estimate that the historic bailout of the financial system, including various credit guarantees, had exposed taxpayers

A NEW BREED OF MUTUAL FUNDS TO THE RESCUE?

Here's how Boston University economist Laurence Kotlikoff would reorder the financial system

BANK DEPOSITS

Banks couldn't lose depositors' money. Deposits would be safeguarded in a mutual fund that holds nothing but cash. Withdrawals would be via check or ATM, as now.

LOANS

Banks wouldn't be exposed to loan losses. All loans would be made by mutual funds using money raised from investors. Those investors would swallow any losses from defaults.

INSURANCE

Insurers couldn't be ruined by big claims. Policies would be issued by a mutual fund that collects insurance premiums. Payments would be limited to whatever is in the fund.

INVESTMENT BANKS

These would become pure advisers. They would be banned from holding assets or borrowing to buy them, so they would not be exposed to market losses.

to potential losses approaching the unfunded liabilities of the Social Security system. "The problem," he writes in his book, "is the leveraging of the taxpayer by people with no formal training in finance or economics, no personal downside, an assortment of Napoleonic complexes, the money to buy ratings in New York and policy in Washington, and the ability to run circles around regulators."

Kotlikoff dove into the minutiae of banking, picking the brains of experts and bouncing ideas off them as he went, from conservatives such as Michael Boskin of the Hoover Institution and Kevin Hassett of the American Enterprise Institute to such liberals as Robert Reich of the University of California at Berkeley and Simon Johnson of Massachusetts Institute of Technology, all of whom provided blurbs for his book. "A lot of us got into this to save the world, and we're still trying to save the world," says Kotlikoff. "It's more important than ever."

In Kotlikoff's scenario, banks would be shorn of their risk-taking functions. A deposit would be pooled with other deposits in a new kind of mutual fund, equivalent to a stock mutual fund but with all the money held in plain old cash so there's no chance of not getting it back (though it could still lose value to inflation). That eliminates any reason for a panicky bank run. Mutual funds would supply loans, too. Already, companies raise money by issuing bonds, which are bought by fixed-income mutual funds on behalf of investors. Kotlikoff says loans could work the same way: Mutual funds would pool investors' money and use it to make loans to vetted borrowers. That would cut banks out of the picture, except as go-betweens. The advantage is that if certain borrowers didn't repay, there would be no systemic, global-economy-threatening crisis, like the ones that can occur when one bank goes down and drags others with it. Instead, the worst that could happen is that investors who funded a particular loan would lose part or all of their investment. Insurers couldn't go bust, either, because they would no longer be on the hook for paying claims. People who wanted insurance would simply pool their money for a certain period, and those with verified claims would divvy up whatever was in the pot at the period's end.

One side benefit: Kotlikoff says 100-plus regulatory agencies could be disbanded because financial firms would no longer have other people's money to play with. They would be replaced with a single Federal Financial Authority whose main job would be to verify data supplied by would-be borrowers, such as income statements and the value of collateral.

Some financial economists worry that Kotlikoff would throw out the good of banking along with the bad. "We did not have airplane crashes when people used horses for transportation, but going back to using horses is not the solution to eliminate airplane crashes," says René Stulz of Ohio State University's Fisher College of Business. Anil Kashyap of the University of Chicago Booth School of Business says there's a synergy in banks between taking deposits and making loans. "To chop up the bank and presume that you can do so without destroying some value is a doubtful theoretical proposition," says Kashyap.

Bank lobbyists, meanwhile, don't even want to entertain the idea. The American Bankers Assn. declined multiple requests for interviews on the Kotlikoff plan. No member of Congress has taken up limited-purpose banking as a personal crusade.

Still, seemingly impossible schemes have become reality before. MIT's Johnson likens now to around 1900, when the smart money said John D. Rockefeller's immense Standard Oil trust was impregnable. Then came trust-busting President Theodore Roosevelt and muckraking journalist Ida Tarbell. By 1911 the Supreme Court had broken Standard Oil into 34 companies. Predicts Johnson, who has his own book on financial reform coming out soon: "The same thing is going to happen with regard to massive, too-big-to-fail banks."

Few others are willing to go that far. But Kotlikoff senses he's gaining momentum. Looking across the frozen Charles, where Harvard and MIT loom large, he allows himself to dream. "It's a big kick to see that we can compete with these guys in something. Maybe it's financial reform." |BW|

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Sudden Fame in Britain

The British press had a field day after Bank of England Governor Mervyn King cited Laurence Kotlikoff three times in a speech in Parliament on Jan. 26. *The Times* of London wrote that members of Parliament "were left scratching their heads over the identity of a little-known American economist who, it appears, has been bending the Governor's ear." King didn't endorse Kotlikoff's plan but said it merited "debate and discussion."

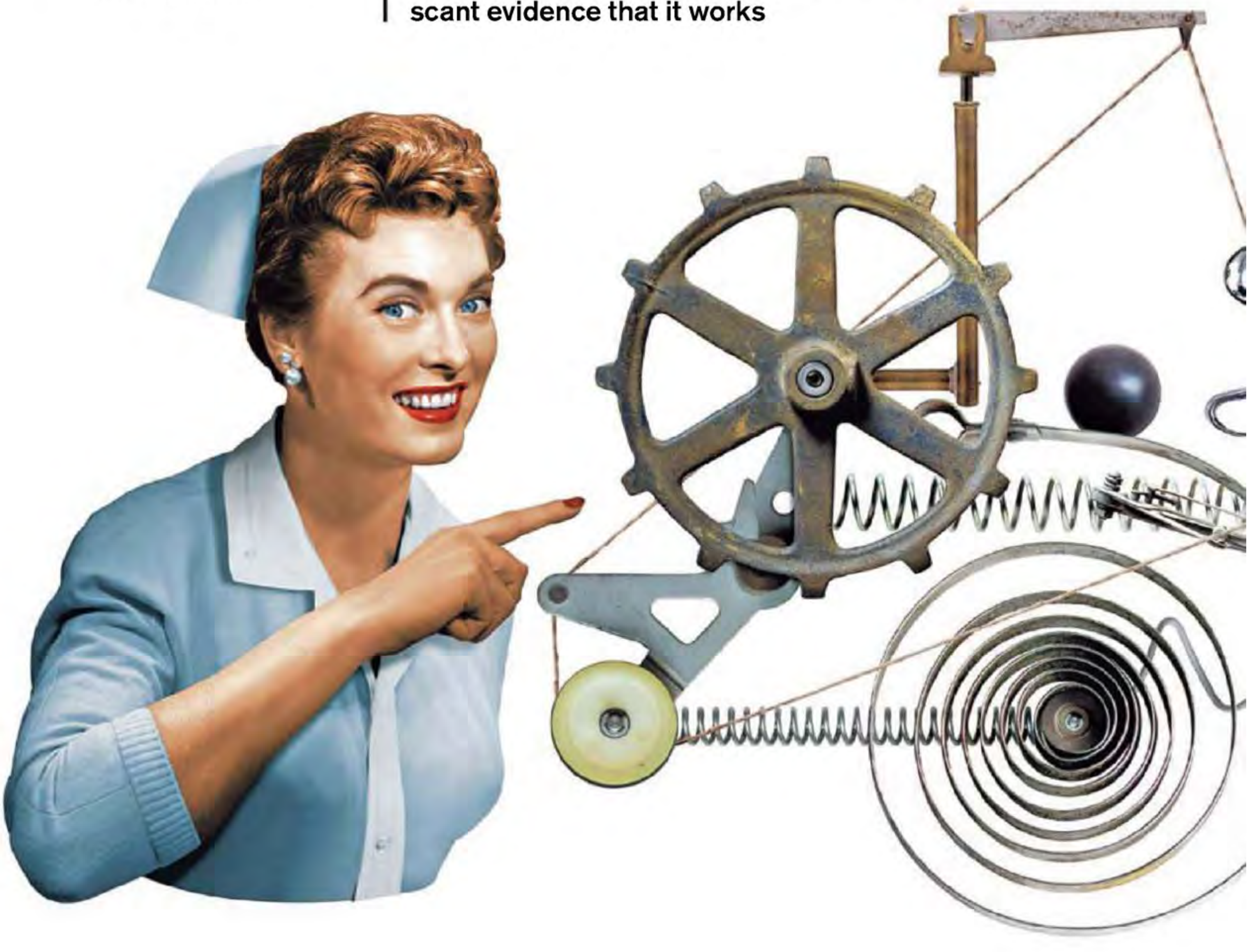
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TAKE YOUR MEDS, EXERCISE—AND SPEND BILLIONS

By Chad Terhune and Arlene Weintraub
Illustration by Viktor Koen

Washington wants to pump big money into so-called disease management, though there's scant evidence that it works



A decade ago General Electric experimented with a promising approach to employee health care known as disease management. It hired a company to talk with workers in North Carolina who suffered from heart disease. Nurses called to encourage them to take their medication and get moderate exercise as a way to avoid expensive hospital stays. Around the same time, large corporations in many industries began paying for similar disease-management programs to keep employees healthier and cut costs. "It seemed too good to be true," says Dr. Robert S. Galvin, GE's chief medical officer. And, he adds, it was.

During the trial, GE didn't see any compelling evidence that disease management saved money or substantially improved worker health. Galvin decided against expanding the program.

In exercising that caution, he is a lonely figure. Disease management—despite a series of studies finding that it doesn't deliver what it promises—has caught on throughout the business world (BW—Feb. 1 & 8). Employers and government agencies are spending a total of $2.5 billion a year on the services. Aetna, Cigna, and other insurance giants sell disease management. Healthways, the leading company in the field, has seen its share price double over the past year, as Wall Street anticipates health reform legislation that will provide incentives to adopt the approach.

Even with serious doubts hanging over the Obama Administration's campaign for change in the insurance system, Congress is expected to approve some kind of slimmed-down bill that will promote disease management. That perplexes Galvin and other skeptics. At GE, a company known for savvy management of employee benefits, "the idea that you are going to save enough on hospitalizations to save money over and above what the [disease-management] program costs just didn't pan out," he says.

Companies marketing disease management counter that in-house research shows such services sharply reduce costs. In Washington the industry has spent generously on lobbying to convince politicians in both parties that the government should expand the business. Lobbyists have distributed an industry-generated study showing that disease management and related efforts could save Medicare, the public insurance




"I'm worried we could throw more money down the drain," says researcher Brown

CHRIS CRISMAN

program for seniors, $652 billion over 10 years.

But outside analysts say the case for disease management—and the data its marketers emphasize—typically rely on exaggeration and ignore the cost of the service itself. "These companies are making so many claims that are never subjected to any scrutiny," says Soeren Mattke, a senior scientist at Rand Corp., a nonprofit research group funded by corporate and government grants. In August 2009, Rand issued a report for the state of Massachusetts concluding that disease management could increase employer and government spending in the state by $6.7 billion over 10 years with little overall benefit. Specifically, Rand said that even when researchers used "highly optimistic assumptions," the cost of the services made any savings negligible. One reason: A lot of preventive attention ends up directed at relatively healthy people who wouldn't require hospitalization anyway.

A 3-YEAR MEDICARE STUDY FAILED TO FIND BENEFITS, BUT PROPONENTS SAY DISEASE MANAGEMENT IS MAKING STRIDES

BIPARTISAN SUPPORT

In a separate analysis, outside consultants hired by Medicare determined in 2008 that disease management used in a pilot for 200,000 patients raised spending but didn't reduce hospitalizations, emergency-room visits, or death from chronic disease. The vast discrepancy between the contentions of disease-management companies and those of critics stem from different attitudes toward projections. The providers attribute large dollar figures to the desired long-term benefits of cajoling smokers to quit and telling heart patients to take walks. It's common, for example, for advocates to claim that preventive steps can save millions of dollars over a cardiovascular patient's lifetime by obviating the need for multiple hospitalizations. Extrapolation from such estimates produces huge aggregate savings. But most disinterested analysts, including the staff of the nonpartisan Congressional Budget Office, refuse to tie specific savings to open-ended prevention, citing research that it increases costs overall.

Now Congress and the Obama Administration are poised to commit billions of Medicare dollars in coming years to a health-care solution that may do little good. "We have already wasted a lot of money on disease management," says Randall Brown, director of health research at Mathematica, a for-profit research firm in Princeton, N.J., that studies preventive care on behalf of government agencies. "I'm worried we could throw more money down the drain."

About three-quarters of large companies offer some form of disease-management services, as do most state Medicaid programs for the poor. Employers or the government typically pay

HOW DISEASE MANAGEMENT WORKS

Providers have convinced many big employers that their services save money and improve employee health

IDENTIFY CANDIDATES
Disease-management companies pinpoint patients who rack up large charges related to diabetes, heart disease, and other chronic illnesses

ON-THE-JOB REINFORCEMENT
Employers urge workers to fill out questionnaires about their health; results are used to find people at risk for expensive treatment

TELEPHONE ATTENTION
Nurses call patients for health "coaching," mail them newsletters about their diseases, and urge participants to chart their symptoms online

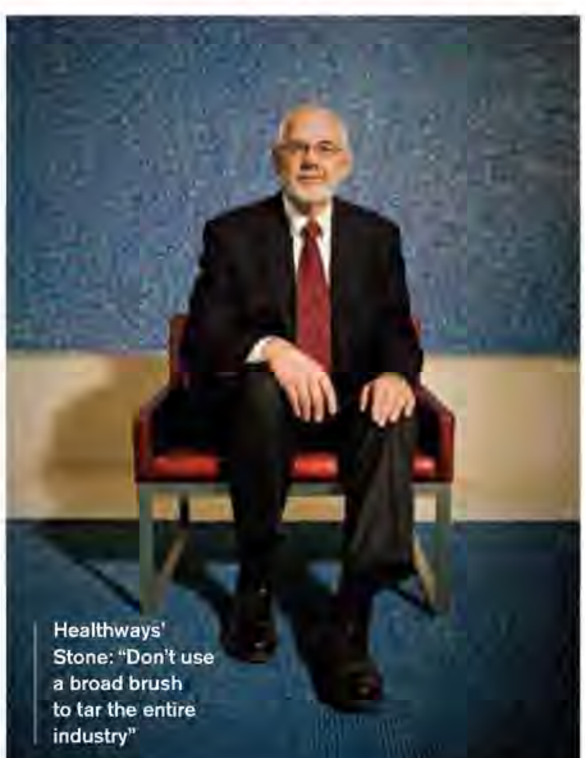
FINANCIAL INCENTIVES
Many employers offer discounts on premiums and free medication to workers who participate in disease-management programs

outside providers monthly fees per member. By sifting through patient data on claims, prescriptions, diet, and behavior, companies try to identify people who are most at risk of requiring costly medical care. They assemble voluminous detail on treatment and lifestyle, using software to predict the highest-risk patients (whose names aren't revealed to employers). Then nurses and "health coaches" call the patients to monitor their conditions between doctor's visits or sometimes after a hospitalization. They check on whether patients are taking their medication, eating right, and getting enough exercise. They sometimes install devices in people's homes to track changes in blood pressure and weight. The programs, which first appeared in the late 1990s, often provide incentives to persuade patients to participate, such as discounts on insurance premiums.

In Washington there is bipartisan support for allowing employers to grant bigger incentives to employees who participate in disease management. Current law allows a 20% discount on premiums; a Senate proposal would expand that to 50%. The industry also stands to benefit from proposals in Congress to spend more taxpayer money up front on preventive care for the chronically ill.

Executives with disease-management companies say studies raising doubts about their services have looked at crudely designed programs from years ago that focused on just one disease at a time, rather than taking a more comprehensive approach. Newer services are much more effective, they contend, and allow for the projections of huge savings. The executives say they're reaching out to more doctors' offices and putting more care managers in the field for face-to-face visits with employees. "It's hard for any third party to conclude we aren't successful," says Robert E. Stone, a Healthways co-founder and vice-president. "Don't use a broad brush to tar the entire industry."

Inside the Healthways headquarters in suburban Nashville, posters urge workers to fill out detailed annual health-risk assessments. The sweet potato fries in the cafeteria are baked, not fried. The main hub of activity is a second-floor call center where about 200 nurses and health coaches wearing headsets sit in cubicles and scan patient files on their PCs. Nurses talk to diabetics about their blood sugar levels and to heart patients about aerobic exercise. Healthways has 11 call centers in the U.S. and three overseas. About 12,000 calls go out a day; most last less than 15 minutes.



Healthways' Stone: "Don't use a broad brush to tar the entire industry"

CAUSE FOR SKEPTICISM

The company was one of eight that participated in the 3-year Medicare pilot that ended in 2008. Medicare paid the disease-management providers about $360 million in fees, but outside consultants found no evidence of improved outcomes. Disease management worked in some individual cases, and some patients liked having nurses check with them, but the pilot group didn't enjoy better health overall, the study found.

The companies that participated contend the government botched the experiment and should have allowed it to continue for a longer period. Medicare enrolled patients in the pilot who were far sicker than expected and failed to share information adequately on hospitalizations, lab results, and use of prescription drugs, the companies say. "I would argue [that Medicare] didn't prove or disprove anything relative to the value of disease management," says Jeffrey Kang, chief medical officer at Cigna, one of the participants. "It was like we were executing with one hand tied behind our back."

Medicare continues to explore ways to help chronically ill patients, says spokesman Peter Ashkenaz. The agency cannot comment on the disease-management pilot because the companies involved are contesting the cancellation, he adds.

"We believe we offer a clear business model for the government to pursue for the 30 million people in Medicare fee-for-service," says Ben R. Leedle Jr., chief executive of Healthways. "It isn't

JOHN CHIASSON; ILLUSTRATIONS BY STANFORD KAY (BW)



Advocate Thorpe makes the industry's case in the capital

an option to just leave people with chronic illnesses alone."

William Evans, a 71-year-old retired finance manager in Snellville, Ga., says he has benefited from disease management, an opinion echoed by many other individuals. Through his Humana Medicare Advantage plan, Evans receives a call once a month from a nurse checking on his rheumatoid arthritis. At first, he resented some questions she asked, such as whether he could move his fingers or tie his shoes. "They were old fart questions," he says. But the nurse effectively monitored his health and even helped him handle insurance claims, Evans says. "I have her number, and she's easy to reach."

At GE, disease management didn't work on a broad scale, according to Galvin, who was a primary-care physician for 10 years before joining the company. He says he had a hard time believing that chronically ill employees would change unhealthy behavior at the direction of unfamiliar nurses calling from remote offices. Still, he didn't want to dismiss the idea entirely. So in 1998, GE tested a disease-management program with employees in North Carolina who had already suffered heart attacks and were likely to end up with repeat hospitalizations and other expensive treatments.

The program failed, Galvin says. GE struggled to get enough enrollment to justify the cost, and those who did enroll rarely responded to the nurses. Galvin went so far as to listen in (with permission) on nurses' conversations with employees. It was all too impersonal, he concluded. "If you're going to influence someone, you need a social relationship with them," he says.

Galvin and some other medical experts favor a different tack: paying physicians a bonus to hire nurses and other care managers who will get to know patients and monitor them effectively. "They'll grab [patients] on the way out, and they'll know their wife—that's how these things change," he says. "Why don't we try to rebuild the doctor's office, rather than make these separate disease-management companies and insurance companies more profitable by putting in call centers and headphones?"

This spring, GE will start an outreach service that shares some elements with traditional disease management. Nurses will use claims data to identify gaps in care, such as unfilled prescriptions or missed checkups. But rather than just contacting patients, the nurses will also call the treating physicians, if patients agree. "Never hooking in the doctor was a terrible negative" of programs such as the one GE tried in North Carolina, Galvin says.

$652 billion

National savings Healthways claims can be gained from preventive care

A POWERFUL LOBBY

For much of the past year, the providers have been promoting their wares in Washington. Healthways officials say they've lobbied fiscally conservative Democrats who are swing votes on health reform legislation. Their claim that prevention programs could save Medicare $652 billion over 10 years reflects industry assumptions that disease management would dramatically increase the percentage of healthy seniors entering Medicare at 65 and keep them fit for years to come.

Support for the services has also come from the Partnership to Fight Chronic Disease, a nonprofit founded in 2007 and funded in part by disease-management companies, insurers, and other medical groups. Its paid executive director is Kenneth E. Thorpe, a health policy professor at Emory University in Atlanta. Thorpe, who worked on health reform as a Clinton Administration official in the 1990s, says he has met regularly with congressional staff members to explain what the federal government should do to combat chronic disease. One important answer, he says, is disease management. Stone, the co-founder of Healthways, describes Thorpe as the industry's "go-to guy."

Thorpe argues that Congress should invest in chronic-care management much like it did when it allocated $19 billion in last year's stimulus bill to speed the adoption of electronic health records among doctors and hospitals. He has told lawmakers that an investment of $30 billion over 10 years could reap huge long-term savings. "We need to make a small investment to build care coordination into Medicare," he says.

Within Congress, Jim Cooper (D-Tenn.), Healthways' hometown representative, has been a strong supporter. "Healthways is a company that we in Tennessee should be proud of," he told other moderate Democrats when they met with company executives in June. "They are playing a key role in the current political discussion by enriching our understanding of America's health—or lack thereof." It appears that many of the politicians were persuaded, despite ample skepticism from elsewhere. |BW|

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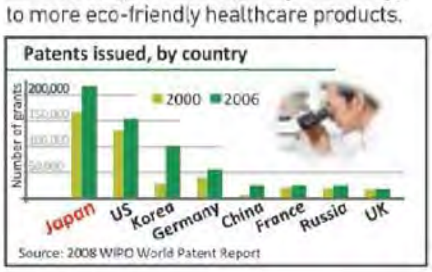
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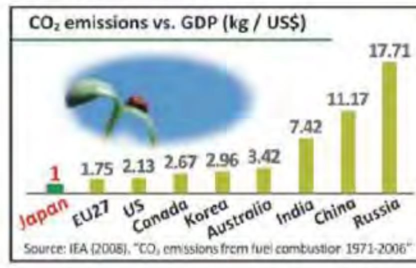


Unique Ideas in Every Corner

Firms across Japan place top priority on research and development. As a percentage of GDP, Japan spends over 35% more on R&D than the US, and more than 2.5 times that of China*. This commitment from the private and public sectors has consistently placed Japan ahead of the curve on technological breakthroughs for the world market. One practical example is Smart Grid, an energy distribution concept using sensor and communications technology to intelligently reduce consumption and costs.

Green Thinking

Environmental concerns are gaining ground with consumers and businesses, and Japan has taken the lead by developing cleaner manufacturing processes, alternative energy sources, more efficient devices and improved recycling techniques. The results have been unmistakable: Japan currently produces less CO_2 per dollar of GDP than any other industrialized nation, and firms here continue to invest heavily in minimizing their environmental footprint. These factors make Japan the perfect choice for those looking for the next generation of eco-technology. GE is working together with Japanese firms of all sizes to meet the goals of its ecomagination initiative. Launched by GE 5 years ago, ecomagination is a company-wide initiative to meet customers' demands for more energy-efficient products and drive reliable growth for the company. It also reflects GE's commitment to investing in innovative solutions to environmental challenges. For GE, Japan has already provided new technologies and ideas, and future "innovation partnerships" look bright.



Investing in Innovation

In July, Japan announced the formation of the Innovation Network Corporation of Japan, a public-private joint venture to create a $10 billion stimulus for small and medium-sized firms in developing and maturing industries, including energy, healthcare and the environment. GE is the only non-Japanese founding member among the 16 private firms who chose to support the initiative to aid the rapid development and commercialization of technologies that will be essential to creating a sustainable future society.

*JETRO, 10 Advantages to Investing in Japan, 2007



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GETTING OVER

Ousted JetBlue founder David Neeleman is taking his dirt-cheap-airline model to Brazil. Will it fly?

By Diane Brady and Adriana Brasileiro
Photograph by Paulo Fridman

David Neeleman is in a good mood. Fresh off a flight from São Paulo and gearing up for a round of TV interviews, Neeleman, 50, agrees to meet over lunch at a Così sandwich outlet in Greenwich, Conn., near his home in New Canaan. The lunch tab for two: $26—fitting for a man building his fourth discount airline and his first in an emerging market. Neeleman has a happy story to tell: Investment firm TPG has just bought a $30 million stake in his Brazilian airline Azul Linhas Aéreas Brasileiras, and Azul has set an industry record, carrying 2.2 million customers in its first year.

Azul's early success is all the more sweet for Neeleman given the bitterness he felt after his ouster from JetBlue Airways. The company had captured consumers' imaginations, and Neeleman, hailed as the model of a passionate leader, could often be spotted passing out snacks on planes or helping passengers check in bags. JetBlue became such a phenomenon that its stock jumped 67%, to 45, on its first day of trading in April 2002. Then a Valentine's Day 2007 ice storm left thousands of passengers stranded and led to Neeleman's ouster by the board. "My reaction was shock and disbelief," says Neeleman. "I got sucker-punched." JetBlue, which declined to comment on the firing, hasn't enjoyed much of a rebound; its stock has since fallen by more than half, to about 5.

After dabbling with the idea of starting an ethanol company in California, Neeleman went to check out a Brazilian airline called BRA Transportes Aéreos as a favor to some investor friends. "It was the furthest thing from an airline I've ever seen," says Neeleman. "I thought, 'If these guys will invest $150 million in this, it must be worth looking around.' " (BRA suspended operations in late 2007.) Neeleman quickly raised $150 million to launch his own startup airline. Then, just as he was finalizing route plans and securing government clearance to fly, the global economy crashed. With his financing and plane orders locked in, he pushed ahead with his launch in December 2008. Remarkably, Azul—"blue" in Portuguese—is on track to make a profit in 2010. Neeleman, the chairman, owns about 15% and controls the voting shares.

Azul's long-term success will depend in part on how well Neeleman has learned from his mistakes. One challenge, says



THE JET BLUES



Neeleman hopes to create a new market of fliers; snacks and smiles help

Vaughn Cordle, managing partner of Washington-based research firm AirlineForecasts, will be curbing his ambition. "The greatest threat is if they let Azul grow above a sustainable rate," says Cordle. "That's what happened at JetBlue." Neeleman acknowledges the Brazilian market's many challenges, from taxes to infrastructure, and insists he's keeping his expectations in check. But in the same breath he talks about the opportunity. He wants to revolutionize the Brazilian market by bringing air travel to the masses. And he wants redemption.


Neeleman as a young missionary in Recife, Brazil (1979)



Neeleman's reaction to being outsted from JetBlue: "Shock and disbelief"


Azul broke an industry record, carrying 2.2 million passengers in its first year of flying

LOCAL ROOTS

Brazil was a logical place for Neeleman to go. He spent his first five years there, the son of a reporter for United Press International who had first visited the country as a Mormon missionary. At 19, Neeleman returned to the country of his birth to do his own two-year missionary stint. In 1984 the college dropout helped create Morris Air, a Salt Lake City airline modeled on Southwest Airlines, which purchased Morris Air a decade later. Neeleman then helped launch Canada's WestJet and developed an airline reservation system called OpenSkies, now used by Ryanair and a dozen other carriers, before starting JetBlue in 2000. He wasn't just the CEO of JetBlue—he was the creative force, an energetic father of nine children (now aged 10 to 28), proudly characterizing his attention deficit disorder as an asset he wouldn't trade for the world.

His time in Brazil left him with two distinct advantages: fluency in Portuguese and dual citizenship, which allowed him to get around Brazil's 20% cap on foreign ownership of airlines. Neeleman's instincts told him Brazil was ripe for a new aviation venture. Only a fraction of its 192 million people currently fly; per capita, Americans fly about eight times more, according to Airports Council International. "We're not even close to the level of air travel in mature economies," says Libano Miranda Barroso, CEO of Tam, Brazil's largest airline, with a 46% market share. "Even our projection for 2027 is equivalent to what the U.S. used to have in the 1970s."

Neeleman is determined to change that by creating a new market of fliers. His target is the 52% of Brazilian households that earn between 1,064 and 4,591 reais a month (about $594 to $2,565), making up Brazil's middle class. They are a fast-growing group that traditionally travels by bus. Many carriers have tried to tap this population, only to be thwarted by strained airports and high costs. As Renato Pascowitch, executive director of domestic Brazilian carrier OceanAir, puts it, fliers "often can't afford to take a taxi to the airport. So how do you get these passengers to board your plane, even if you are offering dirt-cheap tickets?"

Neeleman's reply: "We give them a free ride to the airport." Complementary transportation is all the more crucial because Azul, like Southwest and Ryanair, flies nonstop between secondary airports. Its main hub is Viracopos/Campinas International Airport in Campinas, an attractive and well-run city about 50 miles north of São Paulo. Campinas has about 2.6 million people, and some 30 million live within a 120-mile radius. Azul offers bus service from pickup points in seven cities, with about 50 bus trips a day.

But the real draw is the low fares. Tickets, if purchased in advance, run about the same as a bus trip. Traveling from São Paulo to Salvador by bus, for example, costs about $150 each way and takes 23 hours; on Azul, the lowest one-way fare is just over $100. Cristina Maisonnette of Rio de Janeiro had been planning to drive to Natal, a coastal town, before opting to fly. "I hope they survive," she says of Azul. "I want to be able to fly more often."

Azul offers online booking, automatic check-in, sleek plane interiors, and chatty flight attendants who carry baskets of snacks, telling customers to take as much as they want. Neeleman says Azul's reservations staff often take longer on the phone than at JetBlue because "they're explaining that there's a bathroom on board and a light above the seat."

Like JetBlue in its early days, Azul now has the benefit of a brand-new fleet of planes and a young staff, which means low maintenance costs and cheap labor. Profit margins could come under pressure as costs rise over time and as competitors come in with lower fares to steal business. Even before the ice storm, JetBlue's profitability had been eroding for those very reasons.

But these are long-term concerns; for now Neeleman is excited to be back in growth mode. He spends much of his week in Brazil, meeting with his staff and government officials. He also visits local businesses to talk about customer service and tours college campuses to "preach the gospel of Azul." Much of the time, he's on Azul flights, talking to passengers, showing first-timers how to unbuckle their seatbelts, and taking straw polls over the loudspeaker of how many folks are in the air for the first time. Neeleman has vivid memories of driving 12 hours in the back of a station wagon as a child to see his grandparents. "I always thought it would be so great if we could fly," he says. "For millions of people here, that's now possible." |BW|

(CENTER) DANIEL ACKER/BLOOMBERG NEWS; (BOTTOM) PAULO FRIDMAN

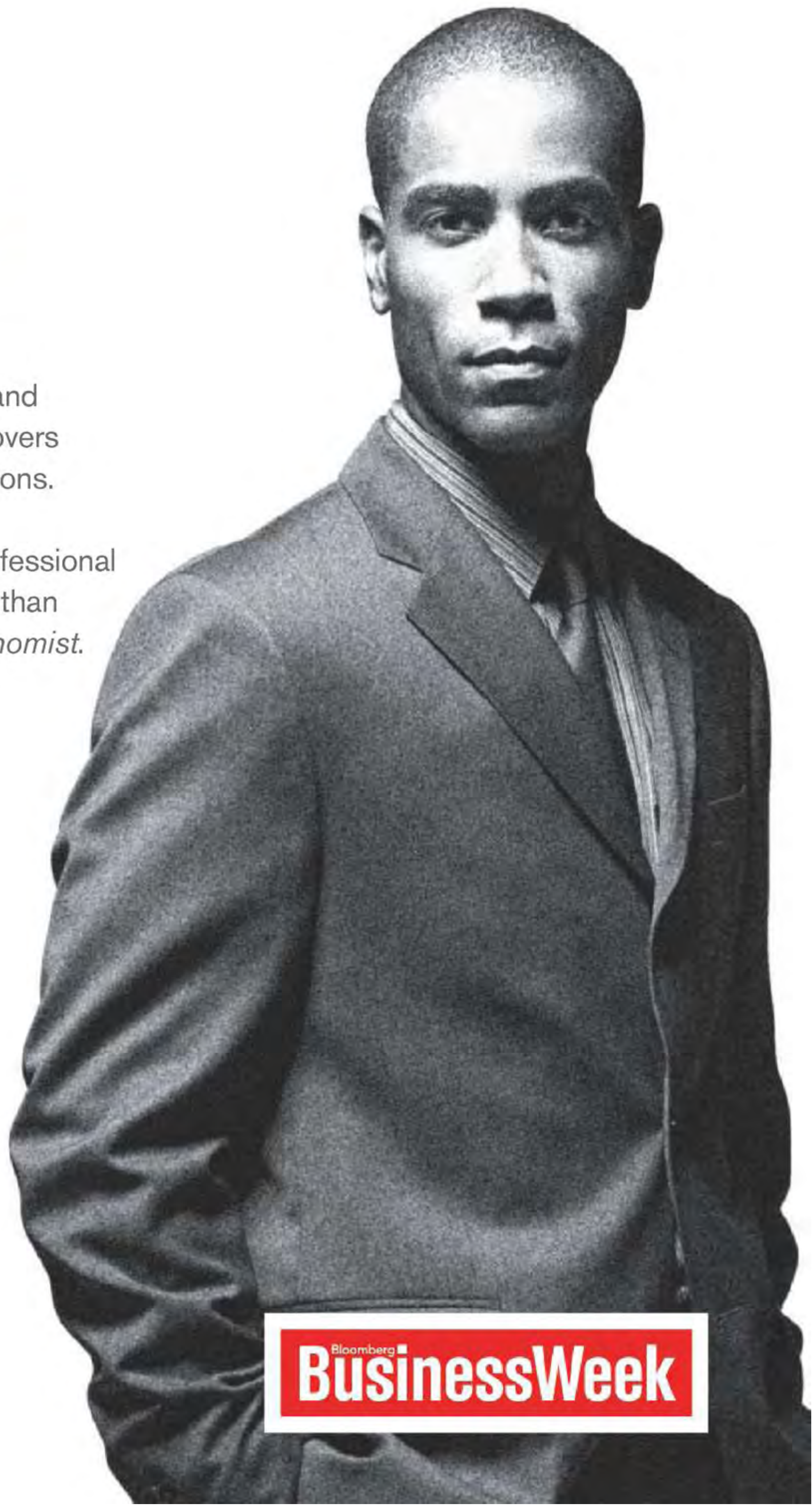
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58 Joe Jimenez' Rx for Novartis
59 U.S. unions in Europe
60 Time Warner's overseas push
61 No love for India's mobile Net
62 Japan's car guys go to China
63 A Fed boon for big banks
64 Goldman's nonprofits profits
66 The 'troll' techies hate

WHAT'S NEXT

ECONOMICS & POLICY

Good to Great Hits Grade School

Behind the success of KIPP, the charter school powerhouse, is a business mentality

By Molly Peterson

Touring a branch of the Knowledge Is Power Program in southwest Houston is like dropping into an underage executive boot camp. The building houses three KIPP charter schools spanning pre-kindergarten to 12th grade—each one a showcase for motivational tactics. The youngest kids wear shirts emblazoned with "Class of 2024," the year they plan to start college. Classrooms are named after Yale and other top colleges. Fifth graders chant their multiplication tables in unison. And the corridors of the middle school are lined with slogans such as "No Shortcuts."

The resemblance to executive training—an intense, communal focus on goals—is no coincidence. KIPP's two founders, Mike Feinberg and Dave Levin, drew lessons from some of America's top companies, including Gap, FedEx, and Southwest Airlines, as they built the program. Both men graduated from Ivy League colleges, and both are alumni of Teach for America, a New York nonprofit that funnels college grads into two-year teaching stints in poor neighborhoods. They and many of their principals have also taken business school classes. "KIPP school leaders are small business owners in many respects," says Elliott Witney, the chief academic officer of KIPP's Houston schools, who keeps a copy of Jim Collins' *Good to Great* in his office.

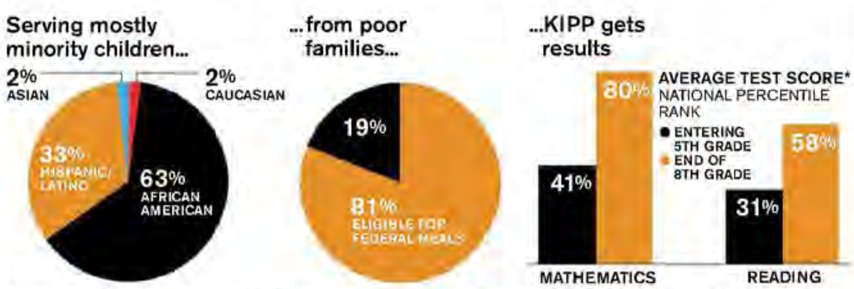
Started in 1994 as an experiment with 50 fifth graders in Houston's inner city, KIPP has blossomed into the biggest U.S. charter school operator, with 82 schools for poor and minority children in 19 states. The Obama Administration cites KIPP schools as models for some of the education reforms it hopes to spur with $100 billion in stimulus money. The program has gotten "remarkable results from students," Education Secretary Arne Duncan told Bloomberg. It helps kids "who didn't really have a good work ethic start to become extraordinarily successful."

Working overtime is central to KIPP's success, as it is at many corporations. Starting with the Houston experiment, Feinberg and Levin instituted nine-hour school days instead of the usual seven, held classes on some Saturdays, and ran summer sessions. Students often spent 60% more time in class than regular public schools require. After one year, the number of students performing at grade level in reading and math jumped to 90% from 50%.

Results kept improving over the next decade. In 2005, a study by the Educational Policy Institute in Virginia Beach, Va., found "large and significant gains" among fifth graders in KIPP schools nationwide on the Stanford Achievement Test Series, a standardized assessment used by school districts. On a scale of 0 to 99, the students scored an average of 9 to 17 points higher in reading, language,

KIPP'S VITAL STATISTICS

Students at schools in poor communities score big gains on standardized tests



*As measured by norm-referenced tests. The four-year growth statistic represents approximately 1,800 students.
Data: Knowledge Is Power Program

CHART BY ALBERTO MENA/BW





Head of the class: KIPP co-founder Feinberg with the Class of 2019

PHOTOGRAPH BY MATTHEW MAHON

and math than they had the previous year elsewhere.

KIPP now has an 85% college matriculation rate, compared with 40% for low-income students nationwide, according to a 2008 report card KIPP prepared and posted on its Web site. About 90% of KIPP's 20,000 students are black or Hispanic; 80% qualify for subsidized meals.

Principals, teachers, students, and parents stay focused on preparing every child for college, says Feinberg, 41, a University of Pennsylvania graduate who heads up KIPP's 15 Houston schools. (Yale University alumnus Levin, 39, runs the system's six New York City schools.) When KIPP students graduate, "It's not just the high school teachers that walk in the commencement," Feinberg says. "The middle school teachers and the elementary teachers that taught those kids walk as well."

KIPP school leaders, who refer to students and parents as "customers," have more control than traditional public school principals over budgets, staffing, and curriculum, Feinberg says. They also continually assess whether students are likely to succeed in college. Schools that fall short can lose the right to the KIPP brand.

WORTH EMULATING?

Some scholars, such as Jeffrey Henig, a political science and education professor at Columbia University, question whether the KIPP experience can be reproduced on a large scale. KIPP staffs its relatively small number of schools by recruiting from a limited pool of top candidates, he points out. About a third of KIPP's teachers and two-thirds of its principals are alumni of Teach for America, which draws heavily from the Ivy League and other highly ranked colleges. "KIPP and Teach for America have shown that it is possible to get bright, enthusiastic, energetic young people [teaching in] schools," Henig says. "But we don't know whether that's sustainable."

KIPP's defenders insist the model is worth emulating. The New York chapter has expanded "in a way that ensures quality control," says New York Schools Chancellor Joel I. Klein. "They have consistently opened up very good schools, and we want to support that."

The nation's 4,900 charter schools, including KIPP's, operate under contracts with school districts or states and receive most of their operating funds from them. KIPP students attend for free and are chosen by lottery. Additional aid comes from organizations such as the Bill & Melinda Gates Foundation and the Walton Family Foundation. Gap clothing chain founders Don and Doris Fisher were early donors, contributing $64 million of KIPP's $130 million tally from philanthropies.

Feinberg wants to expand in Houston from 15 to 42 KIPP schools, serving 10% of the city's public school stu-

dents by 2020. He hopes his program will prod traditional public schools to adopt KIPP methods—just as competition from FedEx inspired the U.S. Postal Service to expand overnight mail. KIPP provides "healthy competition" that "makes everybody better," says Houston Independent School District spokesman Norm Uhl.

Like KIPP, some other charter schools have increased class time, and many regular public schools have started effective after-school programs, Uhl says. Michelle Rhee, head of Washington (D.C.) public schools, has modeled some initiatives after KIPP, including



Levin runs New York's six KIPP schools

Saturday classes and more rigorous summer school.

Could KIPP, or any charter program, become a major catalyst for change in America's faltering public education system? It's not clear, says Gayle Fallon, president of the Houston Federation of Teachers. "Public schools don't always react" the ways companies do, Fallon says. "They'll whine about losing enrollment" to charter schools, "but whether they do anything about it is another story."

Yet KIPP proves that "it is absolutely possible for poor minority kids to achieve at the highest level," says Rhee. She cites a KIPP school in Washington where, she says, 90% of students are performing on grade level, compared with 10% at a regular public school six blocks away. "Same neighborhood, same challenges, same kids with those wildly different outcomes," says Rhee. That's a report card any school would be happy to receive. |BW|

The New Speed Demon at Novartis

CEO Jimenez says his consumer-products background will help the drugmaker pick up the pace

By Dermot Doherty

Joe Jimenez says that more than 20 years selling Clorox bleach and Heinz ketchup taught him to make decisions quickly. Now, as CEO of Novartis, Europe's second-largest drugmaker, he'll try to prove that speed can also make a difference in the pharmaceutical business. Jimenez, 50, is replacing Daniel Vasella, 56, who oversaw the merger of Sandoz and Ciba-Geigy that created Novartis in 1996 and has run the company ever since.

At the moment, Jimenez is basking in the glow of Novartis' fourth-quarter results: Net income advanced 49% year over year to \$2.32 billion on \$12.6 billion in sales, up 28%. But the new CEO, who previously ran the pharmaceutical unit, will soon get a chance to test his reflexes. Novartis' best-selling treatments, the Diovan hypertension pill and Gleevec, a cancer medicine, begin to lose patent protection in 2012, and Novartis—like all large drugmakers—is scrambling to come up with the next generation of medicines.

Jimenez, an American with degrees from Stanford and the University of California at Berkeley, believes his consumer-products background will help. He started his career at Clorox, the world's largest maker of bleach, ran two divisions of ConAgra Foods, and oversaw H.J. Heinz' European operations. With consumer packaged goods, "Decisions have to be made quickly because the market moves quickly," he says. But pharmaceutical businesses have long development lead times, which "tends to slow decision-making in areas where it doesn't need to."

Jimenez oversaw the introduction of kid-friendly green ketchup when he was Heinz' North America chief executive, says Heinz Chairman and CEO William R. Johnson. In 2002 he moved to Europe, where he overhauled management and cut costs by consolidating factories. He served on the board at AstraZeneca and advised the Blackstone Group before joining Novartis to head consumer health in 2007.

Vasella, meanwhile, will stay on as chairman. Having built Novartis into a health-care powerhouse with \$44.3 billion in annual sales, he doesn't plan to retreat into the shadows. When he took over Sandoz, it generated just 45% of revenue from health care. He shed the agrichemicals business and later sold Novartis' medical nutrition and Gerber baby food units to Nestlé for \$8 billion. In a recent interview with Bloomberg, he explained that he decided early last year to step down as CEO in 2010. "The question I'm asking myself is how will I detach myself, how not to intervene but still be here," he says. "I cannot say I'm suddenly disinterested." |BW|

Jimenez (left) will be able to draw on the expertise of Chairman Vasella



(L TO R) PHOTOGRAPHS BY JORDAN HOLLENDER; PASCAL LAUENER/REUTERS



The SEIU on the march outside Sodexo's annual shareholder meeting in Paris

MANAGEMENT & LEADERSHIP

A European Tour For U.S. Labor

American unions are taking the fight for U.S. workers to European employers' home turf

By Carol Matlack
PARIS

Jetting off to Europe isn't exactly Genevieve Repsher's style. As a single mom earning $9 an hour in the cafeteria at Lafayette College in Easton, Pa., "I struggle to pay my bills," she says. But Repsher and a dozen other American employees of Paris-based food service group Sodexo traveled to the City of Light for the company's annual meeting on Jan. 25 to protest its treatment of U.S. workers. At a hotel on the Place de la République, they handed out "Changing Sodexo, Changing Lives" T-shirts to cheering French supporters.

With some 5.5 million Americans employed by foreign-owned companies, U.S. unions are targeting employers on their home turf. They're teaming up with local unions and mounting publicity campaigns to win better treatment for Americans. The Service Employees International Union, which organized the Paris trip, says Sodexo has used "harsh," though legal, measures to dissuade U.S. workers from organizing, such as requiring them to attend anti-union presentations. Multinationals are "engaging in behavior around the world that wouldn't be acceptable in their home country," says Mitch Ackerman of the Washington-based SEIU. "We want to hold them accountable," he says.

THE EMBARRASSMENT FACTOR

Sodexo isn't the only Old World company under attack. Deutsche Telekom, the German owner of cell-phone operator T-Mobile, has been targeted by the Communications Workers of America and German union Ver.di. The two unions have an agreement that would let Ver.di, which represents most of Deutsche Telekom's German employees, sit at the bargaining table with the CWA if it succeeds in organizing T-Mobile's U.S. workers. In Britain, retail giant Tesco faces pressure from British unions and the Washington-based United Food & Commercial Workers, which is trying to organize at Tesco's Fresh & Easy markets in California, Nevada, and Arizona. The UFCW and unions in Europe have secured a deal with Swedish retailer H&M that paved the way for a UFCW contract covering 1,200 H&M employees in Manhattan.

U.S. labor leaders hope to capitalize on the clout and privileged legal status of European unions. In Germany, major unions such as Ver.di get seats on corporate boards, while France's constitution guarantees the right to strike. The Americans also hope to embarrass companies. The SEIU, for instance, points out that most U.S. employees of Sodexo earn less than France's minimum wage of $12.28 an hour. "We've always had relationships with [overseas] unions, but now we're moving from relationships into campaign mode," says Michael Bride, the UFCW's deputy organizing director for global strategies.

European companies defend their treatment of American employees. "We respect the rights of workers and the right to unionize," Sodexo CEO Michel Landel told shareholders at the annual meeting. Tesco says its 3,000 U.S. employees receive competitive wages and benefits and are free to unionize but have shown little interest in doing so. T-Mobile says the "overwhelming majority" of its 38,000 U.S. workers don't want to join a union.

More campaigns are likely. Just as shoemaker Nike bowed to demands by American activists to improve conditions in its Asian factories, European corporate leaders may back down in the face of bad publicity, says Lowell Turner, a professor at Cornell University's School of Industrial & Labor Relations. Says Turner: "They want to protect their brands." |BW|

ED ALCOCK



Time Warner is counting on flicks like Germany's *Two Ear Chicken* to drive growth

MANAGEMENT & LEADERSHIP

At Time Warner, Local Content, Global Profits

CEO Jeff Bewkes is doing production deals abroad to boost revenues. His rivals already have a head start

By Tom Lowry

One of Jeffrey Bewkes' favorite movies these days is *Two Ear Chicken*, a low-budget German tale about a philandering tabloid journalist. No, the Time Warner CEO hasn't become a connoisseur of obscure German cinema. His company produced the romantic comedy, and it is the most popular German film of 2009.

Welcome to what Bewkes likes to call the New Time Warner. Recently slimmed down—so long, AOL and Time Warner Cable—the New York media giant is looking for growth overseas. Bewkes believes it is no longer good enough simply to export films like *The Dark Knight* or TV shows like *The Sopranos*. He wants to produce local programming for audiences around the world. Last year, Warner Bros. released 19 movies for the German market. "We need to get scale in these countries," says Bewkes, "and one way to do that is to ramp up local productions."



CEO Bewkes has made deals in India and Eastern Europe

The Time Warner chief is a little late to the party. News Corp. and Viacom have been hooking up with local entertainment companies around the world for years. With AOL and the cable business gone, Time Warner this year will generate 30% of its revenues overseas, up from 17% before last year's spinoffs. Olaf Olafsson, who runs global operations from New York, says he and Bewkes knew the "one-shoe-fits-all" export model wasn't going to work. "We'd have to tailor-make [films and TV] to fit the markets."

One way to do that is to buy production companies. But Bewkes is a famously cautious dealmaker, especially in the wake of his disastrous 2008 acquisition of British social network Bebo, since offloaded with AOL. So far, his acquisitions have been modest. In December, Time Warner's Turner Broadcasting System shelled out $126 million for a 92% stake in NDTV Imagine, a Hindi-language channel based in New Delhi. In March, Time Warner paid $240 million for a 31% stake in Central European Media Enterprises, a Prague-based collection of TV networks that reaches 97 million people in seven countries in Eastern and Central Europe. Both, Bewkes says, will help bring an "authentic feel" to Time Warner's local productions.

He points to Germany as a template for other countries. There, the company asked Willi Geike, an executive responsible for getting Warner Bros. movies into German cinemas, to scout potential production partnerships. Geike persuaded actor-director Til Schweiger (Germany's George Clooney) to direct and star in a series of films featuring Ludo, the tabloid journalist, and Anna, his kindergarten teacher wife. *Two Ear Chicken* (*Zweiohrküken* in German) was released in December and has grossed north of $41 million. That's a pittance next to a Hollywood blockbuster like *Sherlock Holmes* (from Warner Bros.) which has taken in $390 million since its December release. But Bewkes says he paid no less attention to the daily grosses for *Two Ear Chicken* and sees its success as validation of his global strategy.

Will the wary Bewkes approach get him the international scale already enjoyed by rivals like Rupert Murdoch's News Corp. and Sumner Redstone's Viacom? On Feb. 3, Bewkes told analysts that the international cable TV businesses will generate $400 million in operating profits this year and claimed that will beat out his competitors. Still, if Bewkes' global strategy is to work, says Sanford C. Bernstein & Co. analyst Michael Nathanson, the Time Warner boss may need to think bigger. |BW|

(BOTTOM) PHOTOGRAPH BY EVAN KAFKA

STRATEGY & COMPETITION

India: Nobody Loves The Mobile Net

Enthusiasm over upcoming 3G auctions wanes in the face of reluctant users and prohibitive costs

By Mehul Srivastava
DELHI

Be careful what you wish for. When India announced plans to auction off licenses for superfast 3G phone service, the country's mobile-phone companies cheered. It was August 2007, and their stocks were at all-time highs as more than 8 million new customers signed up every month. 3G, these companies thought, would surely make them richer, faster.

Now, after four delays, the auctions are likely to take place in coming months, perhaps as soon as March. The reaction of India's mobile carriers? More fear than cheer. While the government still hopes to collect a total of $5.5 billion for four national and 22 regional licenses, a price war has driven calling rates to well under 1¢ per minute, slowing the industry's profit growth and denting stock prices. Carriers will need cash to bid on spectrum, and building a nationwide network will cost each as much as $4 billion. "Operators need to be realistic and not overbid," says Naveen Mishra, an analyst at researcher IDC.



Selling phones in Mumbai: 3G auctions could boost foreign control

PRASHANTH VISHWANATHAN/BLOOMBERG

700 thousand Subscribers to BSNL's 3G service 11 months after its launch

Data: BSNL

The 3G track record doesn't inspire confidence. In Europe, overbidding nearly bankrupted many operators. India's state-owned BSNL, which the government allowed to launch 3G a year ago, now offers service in 300 cities, has just 700,000 customers, and has cut tariffs at least twice. The company didn't respond to requests for comment, but its record doesn't encourage rivals. "Now we have to spend billions of dollars on a network that 2% of the country will use?" grumbles a senior finance official at Bharti Airtel, the country's leading carrier, with 116 million customers. "It's not like everybody in a village is carrying a BlackBerry," adds the executive, who asked not to be named because Airtel's official policy is that it's eager to offer 3G to the Indian masses.

The auctions may lead to consolidation and greater foreign control of India's cellular business. The top three operators hold just over half the market, while dozens of smaller players scramble for the rest. Foreigners, meanwhile, are eager to buy in. In 2008, Japan's DoCoMo paid $2.7 billion for 26% of Tata Teleservices, the country's No. 4 operator, and Russia's MTS bought 74% of Shyama TeleServices. Norway's Telenor took an interest in another small player last year.

To raise cash for the auctions, Essar Group, which owns a third of No. 2 carrier Vodafone Essar, is in talks to sell an antenna tower subsidiary to Boston-based American Tower for $420 million. Aircel, a smaller player controlled by Malaysia's Maxis Communications, on Jan. 14 sold 17,500 of its towers to a Mumbai company for $1.8 billion. Idea Cellular, the third-largest carrier, says it has raised $2 billion in cash and loans for the auction—a move designed in part to squelch rumors that the company may be a takeover target. Idea didn't respond to requests for comment. "All of them are going to feel squeezed," says Naveen Wadhera, a principal at Boston's TA Associates, which invested $100 million in Idea in 2006. "But [consolidation] appears long overdue."

Most Indians seem content to use phones for voice calls and texting. Only 40,000 or so iPhones are being used in the country, and smartphones make up well under 5% of the handset market, India's government estimates. Of India's 530 million-plus subscribers, only 2 million regularly use the mobile Net, mostly to download pictures of cricket players and Bollywood stars, according to the Internet & Mobile Association of India, a trade group. "I don't even have an e-mail account," says Delhi taxi driver Ranjit Mishra. With a handset that includes a built-in FM radio, he wonders, "What would I do with Internet on this phone? I have music already." |BW|



STRATEGY & COMPETITION

Japan's Car Guys Cross the China Sea

Mainland automakers are hiring more Japanese engineers to boost efficiency and improve design

By Kiyori Ueno, Yuki Hagiwara, and Ian Rowley

At age 72, Kiyoshi Kondo feels like he has discovered the fountain of youth. After four decades as an engineer at truckmaker Isuzu, where he focused on making vehicles better able to stand up to rough roads, he's taking on a new challenge: helping Chinese carmakers emulate the rise of the Japanese. "It is so much fun to teach," says Kondo. "China is like Japan 30 to 40 years ago."

For the past year, Kondo has regularly jetted off to Chongqing, the great metropolis of western China, to help out at Chongqing Changan Automobile. He has taught the company's engineers to calculate how many staffers are needed at various stages of model development, how to toughen their designs, and more. In one instance, he helped Changan figure out a sophisticated machine for testing the strength of a vehicle's chassis that was standing idle because no one knew how to use it. With his $550-a-day contract now finished, he says: "I want to go back again."

If Kondo doesn't make the trip, others certainly will. While in China, Kondo ran into compatriots from Toyota, Mazda, and Mitsubishi doing similar work. At least 100 experienced Japanese engineers have worked with Chinese automakers recently, reckons Hiromi Shioji, an economics professor at Kyoto University. "If [the Chinese] want to improve the exterior of the car then they go to Italians, but for the guts they are looking to the Japanese," says Akira Ami, president of Global Business Support & Marketing, a consulting company that has sent Japanese engineers to China since 2002.

Some Chinese companies have even set up shop in Japan to tap into the smarts of the country's engineers. JAC Motors, based west of Shanghai in Anhui Province, opened a research center in Tokyo in 2006. The truckmaker has hired dozens of locals to help it develop passenger cars. "Japanese engineers have the mental strength to pursue a problem until it is solved," says Wenjun Wang, chief of the Tokyo center. "Young Chinese engineers don't have the same endurance."

Kondo at home in Nagano after a year in China: "I want to go back again."

There's plenty of work to be done. Beijing has long required foreign automakers in China to team up with domestic joint-venture partners. But the foreigners have been stingy with their technology, so Chinese manufacturers haven't learned as much as the leadership had hoped. Many analysts say it will take a decade or longer before the Chinese make cars that meet Western standards, though Kondo and others like him could help speed things up.

Courted as they are by the Chinese, the Japanese face plenty of cultural hurdles. Though most engineers say they were welcomed by the Chinese, some grouse that the Chinese approach to making cars is too different from Japan's for them to have much of an impact. The Chinese, says consultant Ami, tend to be assemblers, largely outsourcing vehicle development. Ami adds that it's common for the hired guns to be asked to help reverse-engineer Japanese cars—making it easier to copy designs—and that some have been asked to hand over the technology secrets of their former employers.

Kondo nonetheless thinks he has done the right thing. His work in China reminds him of the 1960s, when he learned the latest techniques in vehicle testing from Ford on visits to the U.S. Back then, he says, he was thrilled that foreigners took the time to teach young Japanese engineers the basics of carmaking. "That's how we learned," he says. "I never dreamed then that I might become like them." |BW|

ANDRONIKI CHRISTODOULOU

FINANCE

Lousy CD Rates? Guess Who Wins

With the Fed keeping interest rates low, Citigroup and other banks have made an extra $56 billion

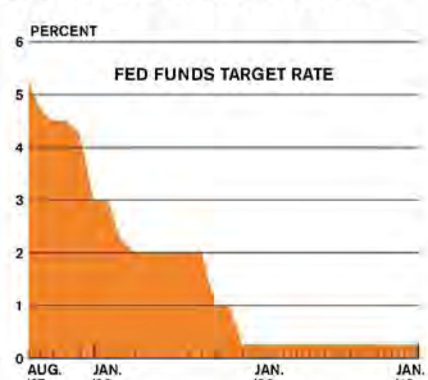
By David Henry

Low interest rates have been hell on savers—and heaven for banks. How heavenly? Try $56 billion. That's the amount U.S. banks booked in extra interest income in the two years after the Federal Reserve started cutting rates in September 2007, according to calculations done for *Bloomberg Businessweek* by researcher SNL Financial.

Banks are getting a pretty sweet deal for nearly blowing up the financial system. Not only did the Fed ratchet down rates to save them, but wary depositors rushed to the comfort of their government-backed accounts. Banks have been able to use those ultra-cheap funds to make lucrative loans and investments since longer-term interest rates have remained relatively high. It's a hidden subsidy that may be as important to the bank bailout as the Troubled Asset Relief Program and the bond guarantees from the Federal Deposit Insurance Corp.



ROCK-BOTTOM RATES



Data: Bloomberg

PAYING THE PRICE

The problem, says Joseph R. Mason, a finance professor at Louisiana State University in Baton Rouge, is that savers are bearing the cost, and they won't be getting their money back. "We are all funding the bailouts, whether we want to or not, both as taxpayers and depositors," he says. As the Fed lowered short-term interest rates to near zero, banks sliced the rates they offered on savings accounts, certificates of deposit, and the like. The average rate paid to depositors dropped from 4.23% in September 2007 to 1.55% in September 2009, according to Dan Geller, executive vice-president of Market Rates Insight, a data firm.

Offering minuscule rates didn't prevent the banks from sweeping up deposits. With the stock and bond markets in turmoil, savers funneled $534 billion into federally insured accounts from June 2008 through June 2009, boosting the total by 7.6%, according to the FDIC.

Banks are making a nice profit on the funds, helping them offset bad loans. Rates on 30-year fixed-rate mortgages declined only 1.24 percentage points during the two years, or less than half the 2.88-point decline in rates paid on a six-month CD, notes Bankrate.com. Thanks to such widened gaps, Citigroup banked extra net interest income of $13.7 billion in the two-year period, according to estimates in its financial reports that include businesses outside its regulated banks. "The banks are making more money than they have ever made" on the difference between their borrowing and lending, says David Bianco, equity strategist at Bank of America Merrill Lynch.

The good times (for banks) will last as long as the Fed keeps rates low—and that could be quite a while. Economists surveyed by Bloomberg believe the Fed won't start raising rates before November, and most expect the Fed to move cautiously as long as unemployment remains high. The low short-term rates, combined with diminishing loan losses, could provide a big boost to banks' bottom lines. If you really get the Fed to hold rates steady, says Bianco, "you could get explosive bank earnings growth in 2010." |BW|

ACME ILLUSTRATORS; CHART BY JOE RHAMES/BW

FINANCE

How Goldman Profits From Nonprofits

Community development groups are helping bankers reduce the risks of lending to small companies

By John Tozzi

SMALL BIZ

After Goldman Sachs and Morgan Stanley became bank holding companies in 2008, Lesia Bates Moss pounced. As president of New York-based nonprofit Seedco Financial, Moss looks for new sources of capital to expand Seedco's lending to small businesses in low-income neighborhoods. Often that capital comes from banks, which, under the Community Reinvestment Act, are rated on how well they serve disadvantaged areas. Investing in an institution such as Seedco, one of about 900 Community Development Financial Institutions (CDFIs), helps banks comply. As bank holding companies, Goldman and Morgan would be subject to Community Reinvestment Act requirements—and therefore, Moss thought, might be persuaded to invest in nonprofits like hers.

Policymakers and bankers expect CDFIs like Seedco soon to play a greater role in small business financing. "Several of the nation's largest banks are developing CDFI partnerships to provide small business credit," says Mark Pinsky, CEO of Opportunity Finance Network, a Philadelphia-based alliance of CDFIs. "I know of at least two significant deals that could launch in the coming weeks." American Express, CIT Group, and GMAC are also newly subject to CRA requirements. "What is occurring now is really a systemic shift in the whole financial markets," says Moss, as banks reduce their risk and their capacity to lend directly to small businesses. "It really supports the case for CDFIs and other alternative lending sources to play a much more critical role to fill that gap."



Moss' nonprofit, Seedco, is getting Goldman funding for its small business loans

HEATHER JOHNSON/REDUX

On Feb. 3 the Obama Administration said it would use up to $1 billion from the Troubled Asset Relief Program to provide lower-cost capital to CDFIs.

CDFIs tap federal funding, foundation grants, and commercial banks to finance businesses, housing, and commercial development. JPMorgan Chase has invested $1.2 billion in the last five years; Bank of America has a $1 billion CDFI portfolio; and Wells Fargo has $400 million in CDFI loans and investments. In November, Goldman announced a $500 million program to aid small businesses. Over five years, some $250 million of that will be lent to CDFIs, with an additional $50 million going to CDFIs as grants. Seedco received $20 million in January.

Critics treated Goldman's announcement as a PR move, but the allocation is real money: about 1% of CDFIs' combined assets. Goldman says its program goes well beyond CRA requirements. Regulators may consider a bank's CRA performance when approving mergers, acquisitions, or other expansions.

Lending to CDFIs gives banks a low-risk way to reach businesses that may become customers. Bankers say their CDFI portfolios have low loss rates, because community lenders take the first losses and because nonprofits provide technical assistance to entrepreneurs. That help "often makes a difference if small businesses are viable or not," says Megan Teare, vice-president for CDFI lending programs at Wells Fargo.

CDFIs have not been immune to the downturn—about 9.3% of loans were more than 30 days past due in the third quarter, compared with 6.25% in 2006, according to industry surveys. But, says Donna Gambrell, director of the U.S. Treasury fund that supports CDFIs, "We have not seen the deterioration that we were fearful we would see." To banks looking to expand their small business loan programs, that's good enough. |BW|


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KEITH NEGLEY

INNOVATION & TECHNOLOGY

The 'Troll' That Ticks Off Techies

Foes say Acacia Research tries to get rich off others' innovations. Inventors say it's a savior

By Rachael King

CEO GUIDE TO TECH

For an executive whose company makes no products, Paul Ryan spends a lot of time fighting over patents. Ryan's company, Acacia Research, acquires patents from inventors and then seeks fees from companies it accuses of infringement. Acacia has filed at least 337 patent-related lawsuits in its 18 years. "We're the go-to company for patent licensing and enforcement," Ryan says. Revenue is expected to rise to $68.8 million this year, from $34.8 million in 2006.

Because Acacia licenses technologies it doesn't design or distribute, it is known as a "nonpracticing entity." Many tech executives—and their investors—call Acacia and its peers by a different name: "patent trolls." Litigation by these firms "costs the industry billions of dollars per year," says Horacio Gutíerrez, deputy general counsel at Microsoft, which on Jan. 25 agreed to license an Acacia subsidiary's technology covering Internet-map geographical information.

Critics say trolls try to apply patents that are too broadly defined or that cover ideas that existed before the patent was granted. Many say the entire U.S. patent system needs reform. But for inventors who alone can't take tech companies to court over meaningful innovations, the Acacias of the world play a vital role.

"I WOULDN'T HAVE GOTTEN A DIME"

In the late 1970s, airline pilot Paul Ware devised a system for protecting credit-card transactions against fraud and then spent $20,000 of his own money to obtain a patent that was granted in 1987. As he tried in vain to get funding to bring his idea to market, other companies began making their own products based on his idea. It wasn't until 2004, when a nonpracticing entity later acquired by Acacia obtained his patent, that Ware could start collecting licensing fees. "I wouldn't have gotten a dime," Ware says.

To get more than dimes for clients, Acacia files lots of lawsuits—more than twice as many as second-most-active firm Rates Technology, says researcher PatentFreedom. Acacia says it reaches out-of-court settlements in roughly 95% of the lawsuits and that it wins about half the cases that go to trial.

For those who prevail against Acacia, victory feels sweet. "Patent trolls are like neighborhood bullies," Robert J. Shillman, CEO of machine vision-system maker Cognex, said in 2008. "They can only be stopped by standing up to them."

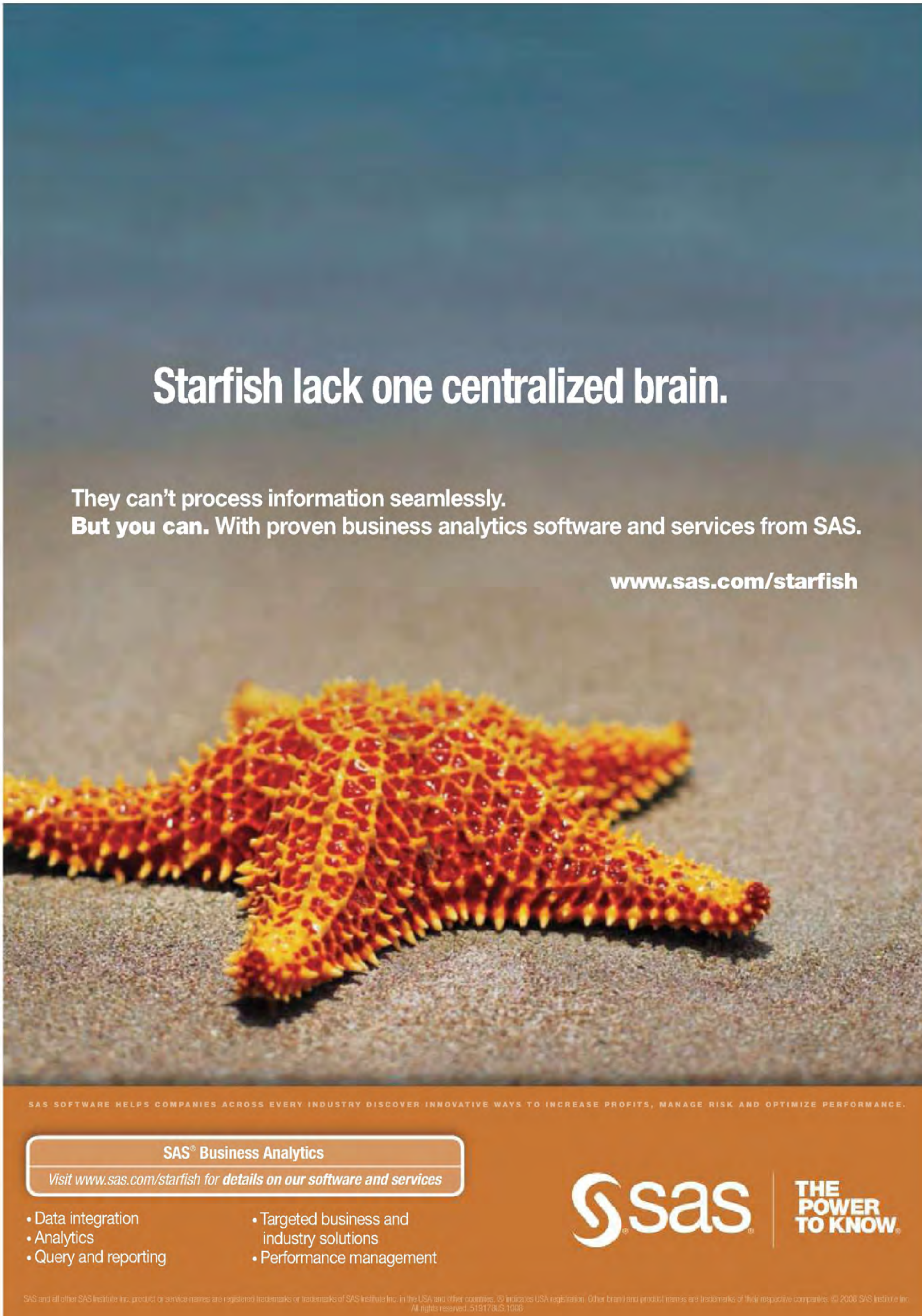
At the same time, nonpracticing entities help bring transparency to a market in which the price for patents is shrouded in nondisclosure agreements, says James Malackowski, CEO of Ocean Tomo, an intellectual-property consulting firm. In 2008, 2,896 patent-infringement actions were filed, with a median range of annual damages of $2.2 million to $10.6 million, according to PricewaterhouseCoopers. Ocean Tomo estimates that about half the patent lawsuits in the tech industry are brought by nonpracticing entities.

Brad Burnham, a partner at venture capital firm Union Square Ventures, says one-third of his firm's portfolio is targeted by patent trolls. "We're on the very front end of an explosion of frivolous litigation that's going to put a damper on innovation," he says.

A growing number of companies are girding themselves against patent trolls by joining so-called defensive patent aggregators, such as RPX, which buy patents and license them to member companies.

Ryan says more companies are willing to negotiate before a case lands in court. Some have even asked Acacia to seek payment for their patents in much the same way that Acacia represents small inventors and patent holders. Even a troll, sometimes, can be an ally. |BW|

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Starfish lack one centralized brain.
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69 Got enough to retire? Tales from the trenches
72 Bonds: Fix the mix
77 Portfolios: The 401(k) outlook

PERSONAL BUSINESS



Wrapping DVDs at the Netflix distribution center in Orlando, Fla.

MONEY REPORT

PROFIT PICTURE

Shares of Netflix reached a new high of 63 on Jan. 28. That gain—more than $12 in one day—came as the company announced it added 1 million customers in the fourth quarter. The movie subscription service also reported fourth-quarter earnings of 59¢ per share, topping the average estimate of 44¢, and CEO Reed Hastings said Netflix is expected to continue to grow "rapidly and profitably" in 2010. ¶ The news prompted a spate of upgrades from analysts. A report from JPMorgan noted that the company will benefit from an improving U.S. economy and predicted the stock would climb to 70 by the end of 2010. But the long-term outlook for Netflix depends on how the shift to digital streaming affects the company, which was founded in 1977. In 2009's fourth quarter, 48% of its 12.3 million couch-surfing subscribers streamed video. Morgan Stanley analysts think shares could rise as high as 68. Online competitors Hulu and YouTube, as well as rivals with DVD kiosks, like Redbox, remain threats. *-Tara Kalwarski*

EARNINGS

PENNY PLAYS

When a company's earnings miss Wall Street forecasts, its stock usually slips. Over the long term, though, those stocks may be better investments than shares of companies that avoid missing the estimates through fancy accounting footwork. To see which group performs better, Paul Hribar, an accounting professor at the University of Iowa's Tippie College of Business, separated companies into two camps. One group of 1,367 companies missed earnings-per-share (EPS) projections by a penny while maintaining their usual expenditures. The other 2,099 beat their EPS numbers by a cent, but only after adjusting their accounting reserves or cutting outlays on R&D or advertising. On average, the near-miss companies outdid the overall market by 30% over the next three years, while the forecast-beaters lagged the market by 10.3%. *-Michael Arndt*

DIVIDENDS

YIELD HAVENS

In 2009, the number of U.S. companies decreasing dividends was the highest since 1955. According to Standard & Poor's, 804 companies reduced payouts by a total of $58 billion. Looking ahead to 2012, analyst estimates of S&P 500 dividends per share show a projected 18% rise, data compiled by Bloomberg show. Among individual stocks, Johnson & Johnson, which has a 3.1% dividend, will likely raise it to 3.3% in April, and Abbott Laboratories may lift its dividend in March to 3.3%, from 3%, data show. Matthew McCormick, a fund manager at Cincinnati's Bahl & Gaynor Investment Counsel, recently bought shares of both J&J and Abbott on speculation that investors will favor stocks with consistent earnings. ***–Lynn Thomasson, Alexis Xydias, and Francesca Cinelli***

804

Number of companies that decreased dividends in 2009

Data: Standard & Poor's

RICARDO RAMIREZ BUXEDA/ORLANDO SENTINEL/MCT



Fehr, a former Boeing exec, ran into hassles with consulting work after retiring

LANCE W. CLAYTON

RETIREMENT

WISE CHOICES, DUMB MOVES

By Christopher Farrell

Financial planners can advise, books can inform, worksheets can approximate. But they'll never replace the advice you can get from folks who have ventured before you into that great unknown: retirement. To help you avoid dead ends and pitfalls, we asked retirees to look back over their time outside the working world and talk about their smartest financial moves, biggest surprises, and worst mistakes.

Tim and Jackie Fehr

Park City, Utah

It was skiing, not snoozing, that Tim Fehr imagined when he thought about retirement. When the Boeing engineering executive retired in 2001, at age 60, he and his wife, Jackie, knew they wanted to live in a ski community. Every Christmas for more than 10 years the family had vacationed at ski resorts. Soon after he retired they settled on Park City for its many slopes, lively town, and nearby international airport. The Fehrs consider that move one of their smartest. But the absolute smartest thing he did, says Tim, was to work with a financial planner and hire an estate planning attorney to set up trusts for his wife and two adult kids.

The financial wrinkle he considers his biggest mistake came out of consulting work. A former client hired him as chief technical officer. He was paid mostly with stock grants and had to pay income tax on the stock's value at the time of the grant. When the stock traded below $1, that didn't seem like a big deal. The problem came when the stock rose above $10. When he got grants at that price, he had to pay a lot to cover taxes. He couldn't turn around and sell the stock—he was required by the company to hold it for a year, and, as a corporate insider, had other restrictions on when he could sell. He wound up tapping retirement savings to own a stock he had to wait to sell. "Lots of cash out and a lot of paper in," he says. "The risk was much greater than I was expecting."

The most unexpected aspect of retirement for Fehr is how work-life balance is still tough. He used to tell team members at Boeing that a reasonable balance was 60% work, 30% family, and 10% giving back. When he retired, his team asked what his percentages would be. He predicted 50% family, 20% work, and 30% giving back. The reality: 40% family, 40% community, and 20% work—though the line between working and giving blurs. He works for his wife's not-for-profit, the Wildlife Protection Society. "My challenge is to make it function as a legitimate business and meet IRS and state requirements," he says. "It requires me to tap all my MBA knowledge."

Carol Daly

Minneapolis

Carol Daly, 68, doesn't like the word "retire." It stems from a French word with the bleak meaning of "withdrawing" or going into "isolation,"

GOT ENOUGH TO RETIRE?

she says. Daly prefers to tell people she "left behind paid work."

For 25 years Daly worked at the University of Minnesota helping colleges and universities in the state develop lifelong learning programs. Although she and her husband never made more than a combined $100,000, they put three kids through private colleges. She planned on working until 65, but at 56 she lost a part of her work that she loved, as Minnesota state director for Elderhostel, the nonprofit for adult educational travel, when it restructured. (She worked both for the University and Elderhostel.) Three weeks later her husband died from lung cancer at 58. She continued working at the College of Continuing Education at the University of Minnesota until she could tap retirement accounts at age 59½ in 2001.

What has shocked Daly is how well she's doing financially, given the economic trauma of recent years. For 25 years the University took 13.5% of her paycheck for retirement savings and she added another 2.5%. She takes out $6,200 a month from retirement savings and gets another $1,400 from Social Security. About $1,200 is set aside for taxes and another $1,500 is taken out so that she has easily tapped savings.

The best financial move Daly made was selling her home in the suburbs and buying a condo in downtown Minneapolis. The condo has become a hub of her social life. Biggest regret? Working from 2001 to 2006 in the field of adult education, including for her former employer, UMinn, without pay. She stuck around because her identity was so closely tied to her work, she says. Now she's having a blast working on a city arts commission and taking adult education classes. "I wasted some time," she says. "I was too afraid of being discarded or ignored."

Jack and Terry Forsythe

Tucson and Chicago

A cancer scare was a big reason why Jack Forsythe decided it was time to retire in 2006 at age 59. He had been chief tax officer and senior vice-president at Ecolab, the cleaning and sanitation company headquartered in St. Paul, Minn., and had worked there for two decades.

Real estate is at the core of both a good move and a mistake. The Forsythes had bought their Arizona home, which is on a golf course, at the height of the housing boom. But they love the climate. They also love Chicago and their condo there. The mistake was trying to hold on to a third home in a St. Paul suburb. The hassles weren't worth it, and they sold it. "I didn't lose money, but I didn't get what I would have if I had sold at the top," Forsythe says.

The surprise is how quickly he abandoned his identity as an Ecolab executive. He left and that was it. Instead, he and Terry travel the world, attending operas and chamber music concerts and visiting kids and grandkids. |BW|



Daly says leaving the suburbs for downtown Minneapolis was her best retirement move

DARIN BACK

HIJACKED BY HEALTH-CARE COSTS?

We asked two certified financial planners about the smart moves, mistakes, and surprises they see among clients

Julie Schatz, CFP

Menlo Park, Calif.

SMARTEST MOVE Cutting spending so they take less out of a retirement portfolio, especially when it's down like now.

BIGGEST MISTAKE First, entering retirement with a third or more of assets tied up in one company's stock. Second, applying for Social Security at age 62 without running the numbers first.

SURPRISE Forget needing only 70% of preretirement income. Many retirees take up hobbies, and hobbies are expensive. The biggest surprise: Health-care costs, especially if retiring before age 65.

Percy E. Bolton, CFP

Pasadena, Calif.

SMARTEST MOVE To do some sort of retirement plan as the age for retiring nears. It gives a good idea whether they have the income and assets to live the lifestyle they expect. Most don't know.

BIGGEST MISTAKE They leave work prematurely and find out later they didn't save enough, largely due to high and rising medical costs. They didn't realize how much time they'd spend at the doctor's.

SURPRISE Clients think retirement means peace and quiet. But there are so many decisions to make, from helping the kids to figuring out what to do with the house.


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RETIREMENT

HOW TO FIX YOUR BOND MIX

By Tara Kalwarski

If the Federal Reserve raises interest rates later this year to keep the economy from overheating, hip, hip hooray, right? That means the Great Recession really is in our rearview mirror. But harrumph might be the more appropriate response from many current or soon-to-be retirees, who could see the prices of their fixed-income holdings slump as a result.

Investors put more than $356 billion into fixed-income mutual funds last year, over 10 times as much as in 2008. But higher interest rates go with lower bond prices. And for most investors, who tend to own bond funds rather than hold individual bonds to maturity, lower prices can foreshadow losses. "If the Federal Reserve raises rates," New York University economics professor Ann Lee explains, "that signals a recovery is under way"—bullish for stocks, bearish for bonds. It's scary for older Americans who, to reduce risk, typically invest heavily in fixed-income assets.

Following the 2001-02 downturn, the Barclays U.S. Aggregate Bond Index, a proxy for the U.S. bond market, lost more than 2% in 2004's second quarter in anticipation of rate hikes. (The Fed went on to boost rates by more than four points, to 5.25%, over 24 months.) This time around, economists don't expect the Fed to increase the federal funds rate from its current 0% to 0.25% range until November 2010, according to a Bloomberg survey. And even then, most are betting on only a quarter-point bump.

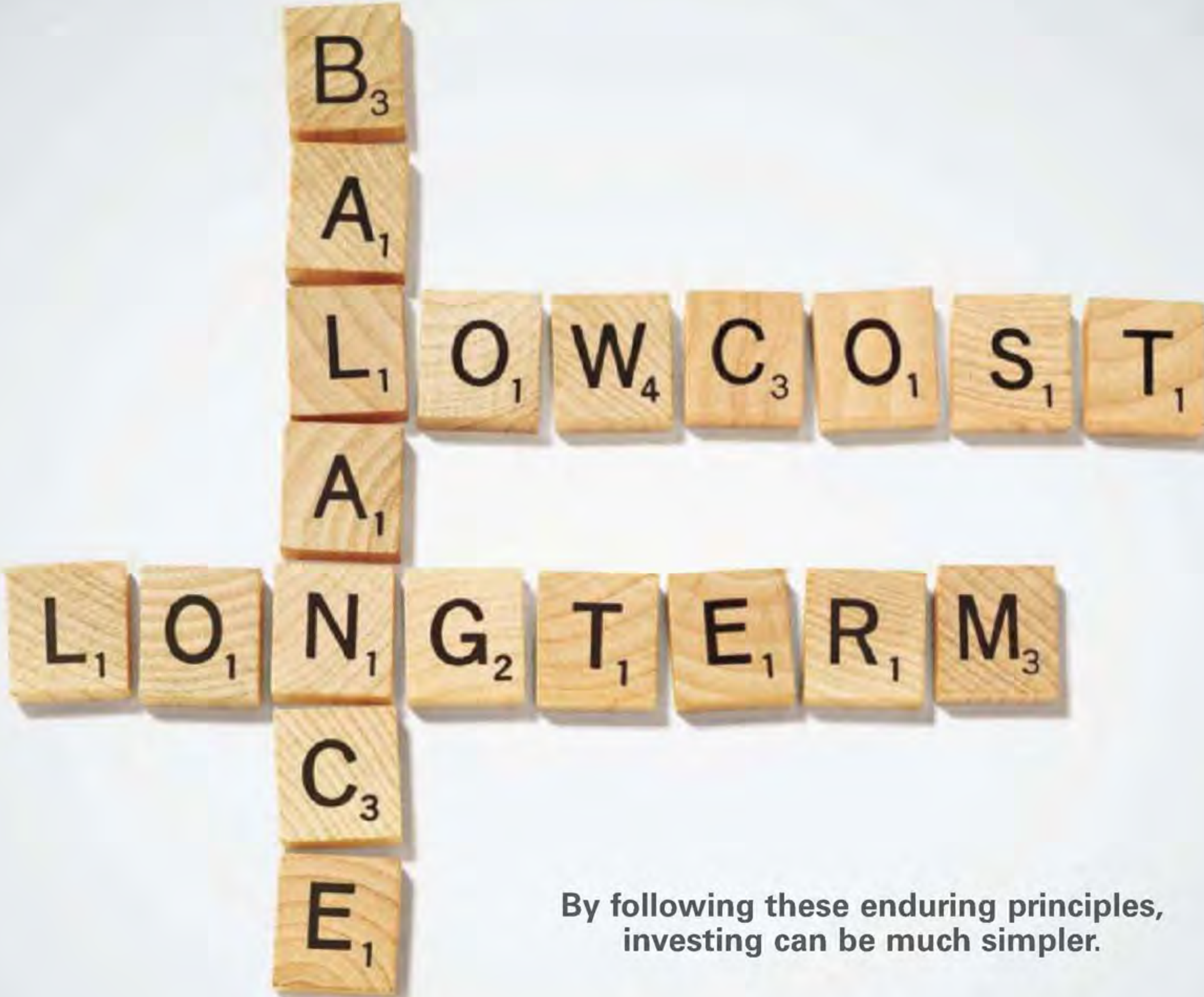
So there's no need for investors—especially those at or near retirement—to rush to sell bond holdings. The smart move is to build a diversified bond portfolio that will offset the impact of rising rates. Here are the strategies experts say are most effective.

GO FOR "GO ANYWHERE" FUNDS

The yields of short-term bonds, which have average maturities of less than three years, have hovered below 1.5% for more than a year. In search of a bigger payout, mutual-fund investors have poured a lot of money into higher-yielding, longer-term bonds. In early 2009, more than $269 billion sat in intermediate and long-term bond funds, according to researcher EPFR. Today $436 billion, nearly 72% of all bond fund assets, are in these longer-term funds. That could become a big problem when rates begin to rise, because the longer a bond's maturity, the more sensitive its price is to rate changes, says Morningstar

MATT BANDSUCH

Simple Truth: Investing can be less puzzling



By following these enduring principles, investing can be much simpler.

Vanguard was founded on a simple set of truths which, if followed, can take much of the guesswork out of investing. Keep costs low, maintain a balanced portfolio, and have a long-term perspective. These truths have never been more relevant than they are today. Discover what seasoned investors have known for decades: If you keep these simple truths in mind, the complicated task of investing can be much simpler. Vanguard. The simple truth about investing.

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GOT ENOUGH TO RETIRE?

TARGET: RETIREMENT

Here's how three funds allocate bonds for people retiring in 2010



*Includes Treasuries, TIPS, munis, and agency debt
**Includes corporate and government debt
Data: Morningstar

director of personal finance Christine Benz.

Benz suggests investors avoid holding only the super-safe stuff, like Treasury bonds with maturities greater than 10 years, municipal bonds, government-backed agency bonds, and high-grade corporate debt. Opt for go-anywhere intermediate-term bond funds including Harbor Bond and Dodge & Cox Income, whose experienced managers know how to navigate this kind of market. Savings investors need to tap within the next five years should be in cash, money market funds, very short-term Treasury securities, or a fund like T. Rowe Price Short-Term Bond that owns short-term corporate debt, she adds.

NO GUTS, NO GLORY

Most longer-term government bonds yield less than 4% now. That's not much, especially considering the significant risk that rates will rise. Bigger payouts can be found in corporate and foreign bonds, which have yields of 5% or more to pay investors for taking on credit risk. When interest rates increase, these bonds can often offset price drops with their higher yields, and "a strong global economy would improve the credit quality," says Tom Latta, investment management and guidance executive at Merrill Lynch Global Wealth Management. Floating-rate bonds and bank loans issued by low-quality companies also offer higher yields with little interest-rate risk because the payouts adjust along with rates. Latta suggests most investors limit exposure to risky corporate and foreign debt to no more than 15% of their bond holdings.

As with other types of bonds, the higher-risk variety is best bought through mutual funds. Morningstar recommends the Vanguard High-Yield Corporate Fund and Fidelity Floating Rate High Income. In 2004, when rates were hiked, they returned 9% and 5%, respectively. Fidelity New Markets Income Fund, meanwhile, ranks among the best in emerging-markets bond funds, with four out of five stars. Morningstar analyst William Samuel Rocco recommends this fund for investors willing to stick with it over the long haul. Over the past decade it has returned an average of 12% a year. A plus for older investors: The fund's volatility has been moderate, especially for an emerging-markets bond offering.

Multisector bond funds are another way to go. They typically buy both high-yield corporate and emerging-market debt and can invest anywhere. Morningstar favorites include Fidelity Strategic Income and Loomis Sayles Bond.

PROTECT YOUR BUYING POWER

Inflation worries commonly trigger a rate hike. While it's anybody's guess how bad—or mild—price increases may be, "even the smallest amount of inflation is insidious," says Fidelity bond manager Joanna Bewick. Over the past 10 years the consumer price index increased by a modest 2.5% a year—but that adds up to almost 29%. Put another way, a cocktail that cost you $10 in 2000 will cost you an extra $2.90 today. "If you're sitting in cash and aren't taking on market risk, the risk in the erosion of buying power is pretty serious," says Bewick.

To protect against inflation, investors can add Treasury inflation-protected securities (TIPS), whose rates adjust with the rise of inflation and fall of deflation. Benz suggests having up to 30% of a bond allocation in TIPS. But TIPS prices tend to surge when inflation worries abound, says Benz, and "if you buy at the wrong time, it's possible to erode any inflation hedge." TIPS rose 10% last year, so they're pricey. To reduce the risk of buying at a bad time, consider a diversified fund like Vanguard Inflation-Protected Securities.

THINK TOTAL RETURN

Older investors should focus on a portfolio's total return, not just income. Solid dividend-paying stocks bring the potential for capital appreciation as well as income. Morningstar sifted through top dividend-focused funds, including Oakmark Equity & Income, to identify overlapping holdings. A few prospects: Exelon, Diageo, and ConocoPhillips. They have dividend yields of about 4.6%, 4.3%, and 4.2%, respectively. |BW|

CHART BY STANFORD KAY

If 145 Sun Life 145 Financial 145 told 145 you

how 145 many 145 years 145 we've 145

been 145 around 145 without 145 asking 145

for 145 government 145 bailout 145 money,

would 145 you 145 remember 145 our 145 name?

Not 145 that 145 we'd 145 ever 145 do 145 that.

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GOT ENOUGH TO RETIRE?

RETIREMENT

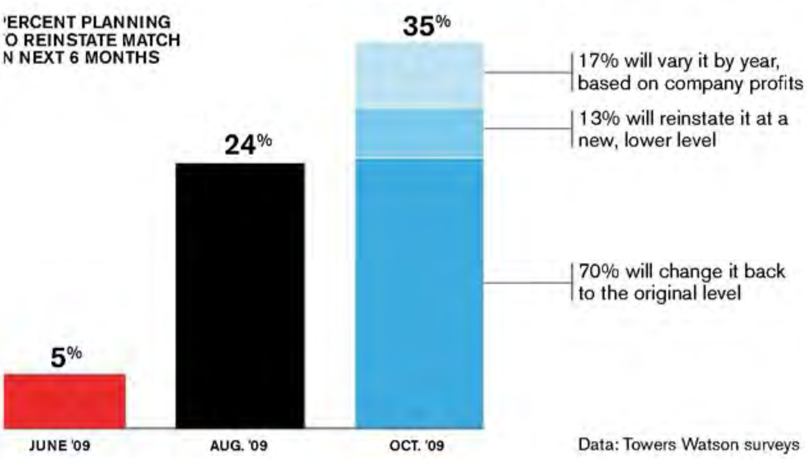
401(k) OUTLOOK

By Amy Feldman

It's easy to obsess about investment returns, but the key to retirement is simple: Save. To live comfortably, you need to start early and set aside at least 10% of your income each year (including any company match). The good news: After being axed in the downturn, 401(k) matches are creeping back, making the 10% target easier to reach.

BRINGING BACK THE MATCH

Large numbers of companies—25%, in one survey—eliminated or reduced their 401(k) matching contributions after the economic crisis began. Now those companies are starting to bring the match back.



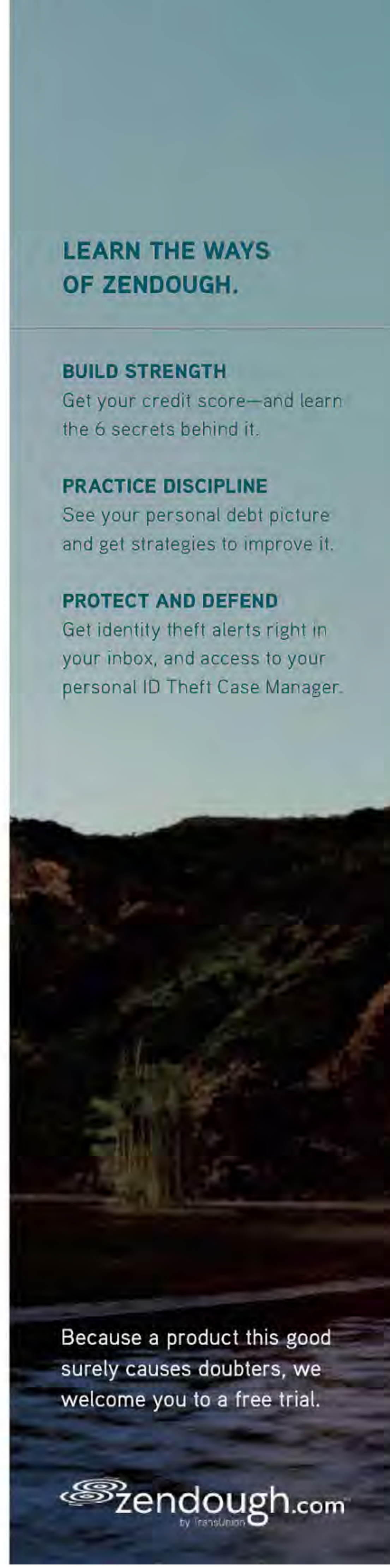
Data: Towers Watson surveys

PERSISTENCE PAYS

How long does it take to recover from a market crash? If you keep contributing to your 401(k), not as long as you might think. Vanguard found that the median account balance for its 401(k) participants who kept investing from Sept. 30, 2007, to Sept. 30, 2009, rose 7%. Younger workers, whose balances were smaller in '07 and so benefited most from those contributions, saw huge jumps—290% for those under age 25 and 62% for those 25 to 34.

PERCENT OF CONTINUOUS PARTICIPANTS	CHANGE IN ACCOUNT BALANCE
60%	Positive or no change
14	-1% to -10%
14	-11% to -20%
11	-21% to -30%
2	More than -30%

Data: Vanguard Center For Retirement Research



80 Tech & You: Now what the iPad Needs Is Cool Content
82 Books: Paulson's *On the Brink*
84 Outside Shot: Bill Clinton On Investing in Haiti

TELEVISION By WALTER KIRN

The Fakery of CEOs Undercover

Like most reality TV, *Undercover Boss*, in which top executives go blue collar, is deeply fictional

Forget about bagging poultry parts or pumping and dumping penny stocks. The dirtiest job in America right now is producing reality TV. It consists of feeding the public's appetite—which has grown insatiable, after years of expert stimulation—with the mixture of sadism and sentimentality, cruel unfairness and poetic justice, ugly situations and happy endings, that most of us know by now are sheer delusions but that we are as helpless to resist as the next market bubble.

Undercover Boss from CBS, in which leaders of big companies must toil for a few days as lowly employees of their own business, is a new series whose theme is sensitivity but whose method, as usual, is humiliation. As suits our recessionary period, the show purports to champion the little guys by letting them have at the big guys. This reverses the Machiavellian script of Donald Trump's defunct series *The Apprentice* (the source of whose former popularity is, like Dow 14,000 or "full employment," almost impossible to fathom now). In *The Apprentice*, power was never abused because power, as the show defined it, was abuse—and withstanding abuse was how power was amassed. In the populist-leaning *Undercover Boss*, power is more Christian. Being able to bow to one's inferiors and draw inspiration from their struggles is rewarded with an even greater power: wisdom.

The show tilts our sympathies toward the meek and mild by showing how they adapt to corporate policies that often appear demeaning, counterproductive, and puzzlingly unnecessary. Meanwhile, the mighty ones who make these policies are forced—mop in hand, so to speak—to suffer their consequences. These interludes of voluntary helplessness, besides being brief, are disingenuous in a way that


Waste Management's O'Donnell hauls trash in the show's premiere



subverts the series' ruling premise. The secret executives know they're on a TV show, while the workers think the cameras are there for other reasons. This information disparity allows the top dogs to frown, sigh, or wince whenever it makes them seem kind, alert, or thoughtful. The little dogs behave by instinct and sometimes seem mean, slow, or odd as a result.

The sudden loss of lofty status that *Undercover Boss* relies on for its corny appeal is a perennially potent dramatic trick. Such dire plunges from great heights happen rarely in real life (at least not to the folks we want them to), and when these tailspins do occur, they seldom yield the searing realizations and earnest apologies that we think they should. *Undercover Boss* grants all our wishes, though, especially our envy-based ill wishes. In the season premiere, Larry O'Donnell, president of Waste Management (the 46,000-strong trash hauler and recycler), is dumped into the mucky trenches where his hefty paychecks come from. Wearing a drab uniform, his millionaire's complexion concealed by a growth of graying stubble, Larry is given a series of yucky tasks meant to stir his conscience, steal his pride, and provoke huge grins of gratified resentment. He's forced to snatch recyclable bits of trash from a speeding conveyor belt. He's made—under the barking orders of a foreman whose chronic kidney ailments have hardened him toward able-bodied slackers—to fill bags with windblown scraps of litter. Finally, he's given a scrub brush and a pump and told to clean and empty a long row of portable toilets at a scabrous fairground.

THE FRAUDULENCE PEAKS WITH THE SHOW'S MESSIANIC MYTHMAKING, BUT ITS FAUX POPULISM IS THE TRUE SHAM

Having learned many tough lessons about the ways his well-meaning company undervalues, overwhelms, and generally jerks around its "front-line" workforce (symbolized by a small group of cheerful stoics who give the company their utmost while enduring sometimes acute hard luck at home), Larry convenes his wary-looking lieutenants to issue corrective orders and share his testimony. As is sure to happen in some form on most every episode of the series (whose upcoming slate of masked corporate chieftains includes those of 7-Eleven and—can't wait—Hooters!), Larry presents himself as a changed man and implies that Waste Management must change as well. The episode ends with a Fortune 500 version of The Sermon on the Mount. Surrounded by admiring workers, including those whom he met during his journey, Larry heralds the coming of a new kingdom.

This finale (and many to come, no doubt) is emotionally irresistible and intellectually preposterous. The idea that the soul journeys of CEOs can redeem or restore American industry in an age of ruthless globalism makes for an enchanting bedtime story, but it's hard to conceive of a goofier approach to—or a more misleading account of—What's Actually Going On Out There. Are the captains of Chinese commerce walking the Road to Damascus, too? No, they're taking shortcuts around Wall Street and the back way to Washington.

Undercover Boss is entertaining precisely to the extent that it's dishonest. The fraudulence peaks with its messianic mythmaking, but its faux populism is the true sham. Because the series' very existence requires cooperation from the executives that it purports to make suffer for their sins, it has to raise them higher, in the end, than it found them at the start. If it doesn't, they'll stop volunteering for their fake lashings and ritual redemptions. "Meet the new boss. Same as the old boss," sang The Who. However he chooses to hide it, scuff it up, or beg forgiveness for misusing it, the power is still his. And that's reality. |BW|



PETER ARKLE

By RICH JAROSLOVSKY

Turning an iPad into An iMust-Have

Apple's new device is lovely and loaded with potential, but it won't fly unless there's cool content to go with it

Steve Jobs chose the wrong name for Apple's new iPad. A better one would have been iWonder—as in, I wonder if content providers will take full advantage of it. Whether they do so will be the key factor in its success or failure.

The half-hour or so I spent playing with the iPad at its San Francisco unveiling last month was too short to evaluate it, other than to say it is fast, beautiful, and loaded with potential. The half-inch-thin iPad uses the iPhone/iPod touch operating system, meaning it runs just about all the 140,000 or so applications already written for those pocket-sized devices. Jobs has promised superb battery life: 10 hours of heavy-duty use.

Apple is currently planning to come out with six models, three of which should be available in March starting at $499 for units that cruise only on Wi-Fi. A month later, a top-of-the-line iPad connecting to AT&T's 3G network will be priced at $829.

It will be interesting to see whether Jobs has showed his entire hand or is holding a little back to keep stoking interest. When the iPhone was unveiled in January 2007, there was no provision for viewing YouTube clips, but an app for that magically appeared before the first models shipped. Techies now bemoan the iPad's seeming inability to run multiple applications at one time. These moans, too, may be premature.

At about a pound and a half, the iPad is heavier than a typical e-book reader, one of its core functions. But the product is about more than that. It aims to deliver media in all its forms, from storing and viewing photos to watching high-definition movies. Its responsiveness is striking. In the photo app, I could race through hundreds of pictures in a blur; the Electronic Arts car-racing game Need for Speed Shift looked terrific on the 9.7-in. screen. Games may look better still once developers start writing to the capabilities of the custom chip Apple designed to power the unit.

Books in the new iBooks app seem much more book-like than on Amazon.com's Kindle or Barnes & Noble's Nook. Pause while turning a page and you see both the content of the one you're on and that of the new page peeking out from underneath, just as if you were holding a physical book.

The question is how fast the media industry can adapt. Are book publishers ready to produce interactive versions that include author interviews and DVD-style extras to take advantage of the iPad's multimedia capabilities? And what about newspaper and magazine publishers? These, after all, are the geniuses who decided to give away their products for free, then expressed shock when people valued the content at exactly the price charged. Will they now recognize the life preserver Apple has thrown them and produce versions optimized for iPads and alluring to readers and advertisers?

It may turn out that Apple's decision to bring its Mac productivity suite to the iPad will be crucial. The three iWork programs—a word processor, spreadsheet, and presentation software—will sell for $9.99 each. With them and a Bluetooth keyboard, or perhaps Apple's new combination keyboard and dock, the iPad becomes an alternative to inexpensive netbooks running Windows software

While that might sell a fair number of iPads, it could also cannibalize sales of more profitable Mac notebooks. More important, positioning the iPad as a netbook would signal Jobs' failure to achieve one of his ambitious goals. To be "revolutionary"—the word he used to describe it—the iPad needs content just as cool as it is. | BW |

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BOOKS

By JIM PRESSLEY

Paulson in the Belly Of the Beast

How the former Treasury Secretary, exhausted and careworn, labored to save the financial system—and made plenty of mistakes

Henry Paulson recalls dining with some of Wall Street's most powerful bankers on June 26, 2007, not long before the credit bubble burst. "All were concerned with excessive risk taking in the markets and appalled by the erosion of underwriting standards," he writes in his penetrating memoir, *On the Brink*. Yet they felt forced by competitive pressure to make loans they didn't like, the former U.S. Treasury Secretary says.

"Isn't there something you can do to order us not to take all of these risks?" was the gist of a question posed by Chuck Prince, who was still running Citigroup as the bank bumbled toward disaster.

That comment encapsulates the bizarre situation that enveloped Paulson as he struggled along with Federal Reserve Chairman Ben Bernanke and New York Fed chief Timothy Geithner to save the free-market system from itself. Banks, hedge funds, and other financial institutions were playing a game of chicken, the economic equivalent of the Cuban Missile Crisis. Paulson's mission was to prevent mutually assured destruction.

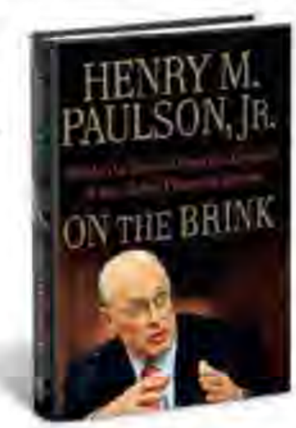
No one can argue that Paulson, a former chief executive of Goldman Sachs, didn't work hard enough. This day-by-day narrative—written with the help of former *Institutional Investor* editor Michael Carroll—reminds us of his punishing schedule. We see Paulson's shiny-headed blur of nonstop phone calls, his late-night meetings, his tossing and turning at night (in boxers and T-shirt). In the middle of the meltdown, George W. Bush pulled a Paulson adviser aside. "Tell Hank to calm down and get some sleep," the President said by this account.

A devout Christian Scientist, Paulson got so worn out that he was tempted to take a pill to sleep. Instead, he flushed the drugs down the toilet. Another night, he managed to fall into a deep sleep, only to get a call from the world's most famous value investor. "Hank, this is Warren," said the voice on the phone. In his grogginess, Paulson says he wondered why his mother's handyman, Warren Hansen, was calling. It was, of course, Warren Buffett.

The big question is whether Paulson's indomitable resolve helped or hurt during the crisis. Though *On the Brink* won't settle the matter, it does lay out Paulson's rationale for taking actions that were repugnant to his own free-market beliefs.

The narrative goes behind closed doors as Paulson and his team endeavored to prop up the wobbling dominos—Fannie Mae and Freddie Mac, Bear Stearns, Lehman Brothers, American International Group, and on and on. We get a persuasive portrait of a man caught between markets, taxpayers, and politicians. Paulson worried about what his "old friends" in Beijing would think; the Chinese, after all, held hundreds of billions of dollars in U.S. debt. Yet his biggest opponent was the global collective of investors. "The market was determined to call our bluff," he says in describing Bear Stearns' shotgun marriage to JPMorgan Chase.

Each bailout upped the ante. As Lehman tottered, Paulson and Geithner were prepared to consider a "Bear Stearns-style rescue," he writes. Yet Paulson told Street bankers ranging from JPMorgan's Jamie Dimon to Morgan Stanley's John Mack that there could be no federal money in a Lehman lifeline. Why? "I knew that unless I explicitly said this, some of them might think that Good Old Hank would come to the rescue."



On the Brink: Inside the Race to Stop the Collapse of the Global Financial System **Henry M. Paulson, Jr. Hachette; $28.99**

Time and again, Paulson admits his mistakes—including intemperate remarks and underestimation of public outrage over taxpayer-funded bailouts—and concedes that he risked distorting markets. While you don't have to accept his arguments, it's useful to know the logic and legal constraints that motivated all those ad hoc decisions. Paulson also works hard to polish George Bush's image. By this account, Bush didn't go AWOL during the crisis; he was "all business, engaged and focused," courageously backing market meddling for the good of the country.

Yet Bush wasn't really up to speed. During one meeting in August 2006, Paulson found himself giving the President "a quick primer on hedging." By then, the bottom was falling out of the subprime-mortgage market. |BW|

COMPANY INDEX

The index lists significant references to companies, top executives, public officials, and well-known figures around the globe.
The folio denotes the first page of the story containing the reference.

A Abbott Laboratories (ABT) 68
Acacia Research (ACRI) 66
Aetna (AET) 46
Aghilli, Parviz 31
Ahmadinejad, Mahmoud 31
Aircel 61
AirlineForecasts 52
Amazon.com (AMZN) 6, 80
American Express (AXP) 64
AIG (AIG) 18
American Tower (AMT) 61
Anthony, Carmelo 13
Apple (AAPL) 6, 34, 80
Arenas, Gilbert 13
AstraZenenca (AZN) 58
AT&T (T) 34, 80
Azul Linhas Aéreas Brasileiras 52
B Bank of America (BAC) 18, 26, 63, 64
Bankrate.com (RATE) 63
Barclays Capital (BCS) 28
Barnes & Noble (BKS) 80
Baxter International (BAX) 24
Berlusconi, Silvio 30
Bernanke, Ben 18, 81
Bernstein Research 30, 34
Bharti Airtel 61
Bigelow, Kathryn 6
BlackBerry (RIMM) 61
Blackstone Group (BX) 58
Blavatnik, Len 6
Boeing (BA) 6, 69
Bosh, Chris 13
Boston Scientific (BSX) 6
Bridgestone/Firestone 21
BSNL 61
C CBS 78
Chonqing Changan 62
Cigna (CIG) 46
CIT Group (CIT) 64
Citigroup (C) 63, 81
Clinton, Bill 84
Clorox (CLX) 58
CLSA 27
Cognex (CGNX) 66
ConAgra Foods (CAG) 58
ConocoPhillips (COP) 72
Cooper, Jim 46
Così 52
CreditSights 34
Crittenton, Javaris 13
D Declaration Mgt. & Research 26
Deutsche Telekom (DT) 59
Diageo (DEO) 72
Directed Electronics (DEIX)
Disney (DIS) 30
DoCoMo (DCM) 61
Dodge & Cox Income (DODIX) 72
Durant, Kevin 13
E Ecolab (ECL) 69
Electronic Arts (ERTS) 80
Elevation Partners 23
Energy Future Holdings 26
EPFR Global 26
Essar Group 61
Exelon (EXC) 72
F Facebook 23, 34
Fannie Mae (FNM) 81
FedEx (FDX) 56
Feinberg, Mike 56
Fidelity Dividend & Income (FSDIX) 72
Fidelity Floating Rate High Income (FFRHX) 72
Fidelity Investments 6
Fidelity Magellan (FMAGX) 6
Fidelity New Markets Income Fund (FNMIX) 72
Fidelity Real Return (FSRRX) 72
Fidelity Strategic Income (FSICX) 72
Ford Motor (F) 21, 62
Freddie Mac (FRE) 81
G Gap 56
Geithner, Timothy 18, 81
General Electric (GE) 17, 46
General Motors (GM) 34
GlaxoSmithKline (GSK) 24
Global Business Support & Marketing 62
GMAC 64
Goldman Sachs (GS) 31, 64, 81
Google (GOOG) 23, 34
H Halliburton (HAL) 18
Harbor Bond (HABDX) 72
Healthways (HWAY) 46
Hennes & Mauritz 59
H.J. Heinz (HNZ) 58
Honda (HMC) 21
Hooters 78
Hulu 68
Humana 46
I IDC 61
Idea Cellular 61
Issa, Darrell 18
Isuzu 62
J JAC Motors 62
James, LeBron 13
JetBlue Airways (JBLU) 52
Jimenez, Joe 58
Jobs, Steve 34
JohnsonDiversey Holdings 26
Johnson & Johnson (JNJ) 6, 68
JPMorgan Chase (JPM) 64, 68, 81
K Kia Motors 21
KKR 26
Kotlikoff, Laurence J. 42
L **LaHood, Ray** 6, 21
Landel, Michel 59
Leedle, Ben 46
Levin, Dave 56
Liberty Media (LINTA) 6
Lions Gate (LGF) 6
Lockheed Martin (LMT) 6
Loomis Sayles Bond (LSBRX) 72
Lynch, Peter 6
M **Malone, John** 6
Mathematica 46
Maxis Communications 61
Mazda 62
McCormick, Matthew 68
McKesson (MCK) 24
Mediasset 30
Merrill Lynch Global Wealth Management 72
MFS Investment Management 6
Microsoft (MSFT) 23, 66, 80
Mitsubishi 62
Mobarekeh Steel Complex 31
Mondus 31
Moody's (MCO) 27
Morgan Stanley (MS) 18, 26, 64, 81
Morningstar (MORN) 6, 72
Morris Air 52
MTS (MBT) 61
Mudrick Capital Management 26
Murdoch, Rupert 6, 30
N NBC 34
Neeleman, David 52
Nestlé 58
Netflix (NFLX) 68
News Corp. (NWS) 6, 30
Novartis (NVS) 24, 58
O Oakmark Equity & Income (OAKBX) 72
Obama, Barack 6
OceanAir 52
Ocean Tomo 66
O'Donnell, Larry 78
P Parnassus Equity Income (PRBXL) 72
PatentFreedom 66
Paulson, Henry 18, 81
Peloton Partners 26
Pepsico (PEP) 34
Phillips, Don 6
Pirouz, Rouzbeh 31
Putnam Investments 6
R RAND 46
Rates Technology 66
Raytheon (RTN) 6
RPX 66
Ryanair (RYAAY) 52
Ryan, Paul 66
S Sanofi-Aventis (SNY) 24
7-Eleven 78
Shyama TeleServices 61
SNL Financial (OFG) 63
Sodexo 59
Southwest Airlines (LUV) 52, 56
Standard & Poor's (MHP) 68
Stankey, John 34
State Street (STT) 26
Stephenson, Randall 34
Stern, David 13
Stoppelman, Jeremy 23
Summit Entertainment 6
T TA Associates 61
Tam 52
Tata Teleservices 61
Telecom Italia (TI) 31
Telecommunications Co. of Iran 31
Telenor 61
Tesco 59
The Envisioneering Group 34
T-Mobile 59
Time Warner (TWX) 6
Toyoda, Akio 21
Toyota (TM) 6, 21, 62
TPG 26, 52
T. Rowe Price Spectrum Income (RPSIX) 72
Trump, Donald 78
Turquoise Partners 31
Twitter 23, 24, 34
U Union Square Ventures 66
United Technologies (UTX) 6
V Vanguard High Yield Corporate Fund (VWEHX) 72
Vanguard Inflation-Protected Securities (VIPSX) 72
Vasella, Daniel 58
Verizon (VZ) 34
Vodafone Essar 61
W **Wade, Dwyane** 13
Waxman, Henry 18
Waste Management (WMI) 78
Weather Investments 26
Wells Fargo (WFC) 64
WestJet 52
Whitacre, Ed 34
Wind Acquisition Holdings Finance 26
Y Yankee Group 34
YouTube (GOOG) 24, 34, 68
Z Zynga 23

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OUTSIDE SHOT



By BILL CLINTON

Business Can Help Haiti

Last October, I attended a historic and successful conference in Port-au-Prince organized by the Inter-American Development Bank highlighting investment opportunities in Haiti. When I first visited Haiti 35 years ago, I wouldn't have imagined that this kind of event would be held in Port-au-Prince, let alone that more than 200 investors and business leaders from around the world would attend—including representation from all over Latin America. Nearly everyone who came was convinced of the opportunity and promise in Haiti for profitable businesses that serve both local and export markets. Many left with new commitments to increase their capacity in Haiti.

Much of this success is a testament to the progress the Haitian government had made toward implementing its comprehensive plan for economic development, even in the face of devastating hurricanes and storms. Since June 2009, I had been doing what I could to help as the U.N.'s Special Envoy for Haiti and through the efforts of my Clinton Global Initiative. And for the first time, I believed the country had its greatest chance to overcome 200 years of oppression, neglect, and poverty.

Even in the wake of the Jan. 12 earthquake, I still believe that. The outpouring of help from the international community has enabled aid agencies to deliver emergency supplies to hundreds of thousands of displaced or injured people. Every donation to fund access to water, shelter, food, and medical supplies saved countless lives. Yet as relief work goes on, many leaders of the business community are looking forward, and asking: "What's next? How can we be partners in Haiti's future?"

Today, perhaps counterintuitively, opportunities in Haiti abound. Amid the destruction, the Haitian leadership rightfully views this as an opportunity to reimagine their country and "build back better" in ways that create jobs, improve education and health care, and enhance environmental sustainability. Nearly every sector of the economy needs investment and offers opportunity, but I'd like to highlight a few specific sectors of particular importance:

Agribusiness: Agriculture and agribusiness weren't severely damaged by the quake. Haiti has tremendous potential to develop and expand here, especially in fresh fruits, vegetables, and coffee—while increasing farmers' pay through high-value exports. Businesses looking to get involved could import and market Haitian coffee or mangoes, or invest in local processing that buys from smallholder farmers.

Rural Infrastructure: Expanding roads and cellular coverage into rural areas will connect farmers to new markets and information while enhancing access to health care. Warehouses and grain storage facilities with receipts systems for farmers have proven to increase incomes. Businesses with know-how in these areas can support projects that extend the power grid and improve functions such as banking and retail transactions.

Renewable Energy: Haiti has the potential to become one of the leading solar countries in the world. As well as lighting off-grid streets and homes (and powering flashlights and radios), solar energy can strengthen other sectors. Solar-powered drip irrigation systems can lift crop yields—even enable a second growing season in some places. Solar energy now powers a fish farming operation that could easily and profitably be three to five times as large.

Reforestation: Large-scale tree-planting projects partnered with small-scale community-based projects would not only protect Haiti's environment, they would create jobs in the fruit and lumber sectors. Businesses can buy carbon credits from community-based tree-planting initiatives in Haiti and advance the government's watershed management and reforestation programs.

Apparel and Textiles: In just the past few months this sector has shown significant signs of progress. Most of the primary facilities survived the earthquake, and many are operational again. Under the U.S. HOPE II Act of 2008, $428 million in goods have been exported to the U.S. duty-free. Brazil is considering a similar relationship. Companies in this sector can invest in apparel and textile factories that integrate everything from weaving and dyeing through packaging.

Call Centers: Haiti could also be an ideal location for offshore call centers, which could serve both English- and French-speaking markets and employ the many Haitians who have recently become amputees or suffered other physical disabilities.

Some businesses and investors are exploring the creation of a pooled investment fund. I encourage these efforts. Years from now, our response will be judged by how many jobs we help create, how many businesses are started or expanded, the vitality of the middle class, and whether investors are able to earn a profit by doing the right thing. I invite you to be a part of this. |BW|

President Bill Clinton is the founder of the William J. Clinton Foundation and is the U.N. Special Envoy for Haiti.

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